

# A Review of China's Grain Marketing System Reform<sup>\*</sup>

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*This paper aims to review and evaluate the process of China's grain marketing reform since the late 1970s. It reveals that through 20 years of reform, China's grain marketing system has been greatly liberalised and marketised. Most of the grain is now sold at the market prices. The market structure has changed and private business companies and individuals play an active role in the grain business. These changes have promoted competition and efficiency in grain marketing sector. Despite the progress, China's grain marketing system still retains many characteristics of the centrally planned economy, and government intervention and administrative methods are still the common practices in grain marketing. The paper argues that while the reforms to date have enabled greater decentralisation and marketisation of the grain marketing system, the pressure for further reforms remains.*

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<sup>\*</sup> This paper draws heavily from Andrew Watson and Christopher Findlay (1999), "Food and Profit: The Political Economy of Grain Market Reform in China", in Christopher Findlay and Andrew Watson (eds) *Food Security and Economic Reform: The Challenges Facing China's Grain Marketing System*, Macmillan Press Ltd, London and New York.

## 1 Introduction

Grain marketing reform is an important component of China's overall economic reforms from a planned economy to a market-oriented economy. Grain marketing reforms that were initiated in the late 1970s were aimed at raising farm level prices and gradually liberalising the market. These reforms included an increase in quota and above quota prices, a reduction in quota levels, the introduction of surplus sales bonuses for major crops, negotiated procurement of surplus production of grains, oils and most other agricultural commodities, and flexibility in marketing of surplus production of all categories of agricultural products privately. These reform measures produced substantial impacts on agricultural production. The shift from the collective to household responsibility system also raised the price responsiveness of farm households. As a result, grain output increased from 320.56 million tonnes in 1980 to 407.31 million tonnes in 1984, with an annual growth rate of 6.17 percent. During the same period, farmers' per capita net income increased from 191.33 yuan to 355.33 yuan, with an annual growth rate of 16.74 percent.<sup>1</sup>

As the right to private trading was extended to include surplus output of all categories of agricultural products, the state planned grain marketing system began to be undermined. The first attempt to move away from the planned grain marketing system towards greater marketisation came in 1985, with the introduction of the contract purchase system. By 1984, the 1978 reforms had restored profitability to grain production and, alongside the management reforms, had generated a substantial boost

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<sup>1</sup> Calculated from State Statistical Bureau, *Zhongguo Tongji Nianjian* [China Statistical Yearbook], Zhongguo Tongji Chubanshe, Beijing.

in output. There was optimism that China's long-lasting problems of grain shortage had been overcome. The peasants were beginning to face difficulties in disposing of grain, and storage facilities were stretched to the limit. State grain retail prices remained low, and the result was a rapid growth in government food subsidies. Overall both producers and consumers had benefited, but government faced huge subsidy costs. Therefore, after a record growth in grain production in 1984, in 1985 the government attempted a new phase of grain market reform.

The following sections discuss in some detail the reform program in grain from 1984 onwards. This includes an outlook of and commentary on the most recent changes in grain marketing.

## 2 Reform from 1985 to 1992

In 1985 the government abolished compulsory sales and replaced them with contract purchase. Each producer household was then expected to sign a contract with the local grain station for the delivery of an agreed amount of grain. The purchase price was a weighted average, with 30 percent of the delivery at the old base price and 70 percent at the old surplus price. The state, however, guaranteed to purchase only the contract grain. Other grain could be sold to grain bureaus or grain processors at negotiated prices, or directly to consumers on the free market. Also after fulfilling the state procurement, storage, and sales plan at official prices, the new policies allowed grain bureaus to engage in free market trade at negotiated prices.

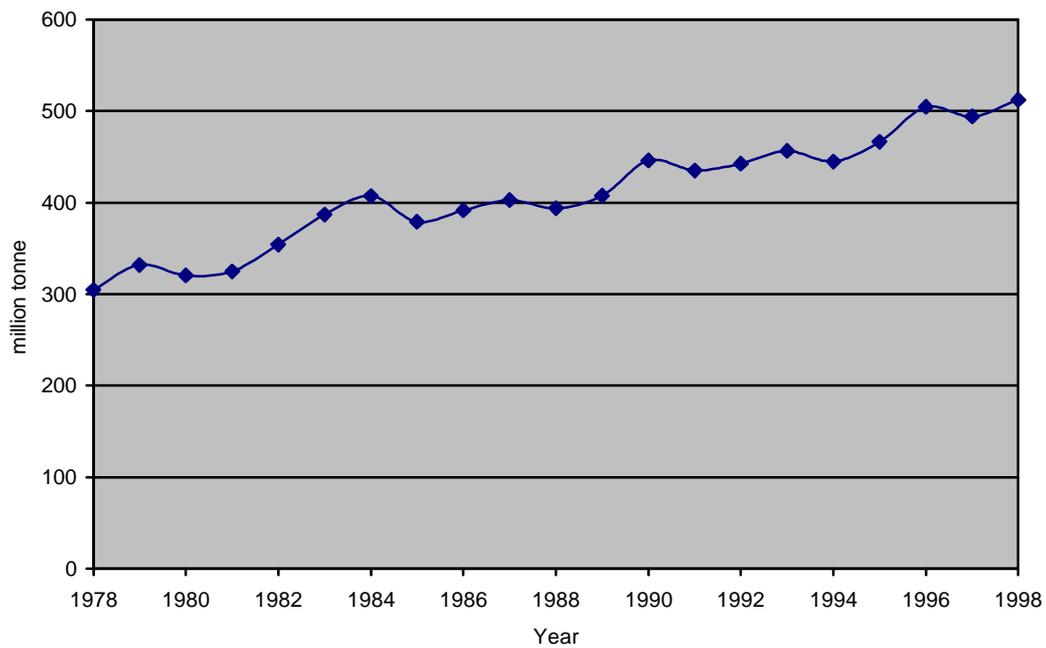
This policy changes were followed by a dramatic decline in grain production. Grain output declined from 407.31 million tonnes in 1984 to 379.11 million tonnes in 1985, dropping 7 percent. The causes of this decline included factors such as bad weather, low yields and a drop in sown acreages. Behind this, however, there were also some fundamental economic reasons. In fact, the changes actually reduced the marginal price to producers.

Producers in major grain producing regions who had previously had a high sales quota may have benefited because their average price rose. This was because the price ratio of 30:70 meant a decrease in the ratio paid for at base prices and an increase in the ratio at the higher prices. Their capacity to go on increasing output was limited, and required an increasing amount of investment. Furthermore, since they were located mainly in the coastal regions, where economic diversification and the growth of rural enterprises was making investment in grain production less attractive, they lacked the incentive to continue to produce grain. The price changes worked in their favour, but could not be expected to stimulate much more output. In contrast, producers in the emerging grain production areas, which had previously had low quotas, had been stimulated by the price changes of the early 1980s, and had responded by increasing grain output. They found that a higher proportion of their recently increased sales was now paid for at lower prices. In addition, any increase in grain output might not have a guaranteed purchase.

Because of the sharp drop in agricultural production in 1985, implementation of the contract purchase policy stalled. Therefore, during the period 1985 to 1988, when most other aspects of reform accelerated, reform of the grain marketing system slowed

down. To ensure supplies, mandatory procurement of grains continued at the “contract price” which basically was a weighted average of the former quota and above quota prices. Eventually in late 1990, the contract purchase system was renamed the state purchase system in recognition of its more compulsory nature. To provide greater incentive for farmers to raise productivity and sell to the government, contract prices were raised over time and the rise of input prices was restricted. Ultimately, grain production recovered to new high levels in 1990 and 1991 (see Figure 1).

**Figure 1 Grain output in China**



Source: State Statistical Bureau, *Zhongguo Tongji Nianjian* [China Statistical Yearbook], Zhongguo Tongji Chubanshe, Beijing.

Based on the situation of high levels of production, stable supplies and flat market prices. In 1991 grain marketing reform was accelerated. The first step was the rise in state retail grain prices in 1991 and further in 1992, which brought the selling prices and the procurement prices into line. These price rises were clearly aimed at reducing the size of the government budget outlays on grain. On the procurement side, the government also adjusted prices upwards in 1992. It was anticipated that this might improve the returns to producers substantially. The reforms during the period of 1991 to 1992 provided experience and opportunities for the next large step of grain marketing reform which occurred in 1993.

### 3 The reform period from 1993 to 1997

As agricultural production and prices stabilised in 1990-92 and also because of the successful experiments of grain marketing reform tried out in some provinces, another attempt was made to abolish the compulsory quota system and the sale at ration prices to consumers in early 1993. The reform included the following main aspects. In the urban areas, grain rationing to urban residents was eliminated in 1993, relying on market forces for staple grain supply. With the end of grain rationing, the need to design and implement an inter-provincial grain transfer plan was also eliminated. Beginning in 1993, all grain transactions between provinces were completed on a voluntary basis. In the rural sector, mandatory quota deliveries were reduced and in some areas were eliminated.

However, both the state distribution and procurement systems were liberalised in 1993, the state compulsory quota system was again reimposed in most parts of China in 1994

and all over China since 1995. This reversed policy was a result of higher food price inflation and the fear of the shortage of food supply. The first signs of potential problems came from reports of the unwillingness of producers to sell grain to state because the guaranteed prices offered to producers were too low. After the announcement of raising 1994 purchase prices, the issues intensified as farmers were encouraged to hold on to stocks in the expectation of a further price increase. At the same time, the grain bureaus were coming under pressure to rebuild stocks. Purchase prices inevitably began to rise. Meanwhile, consumers, who faced high inflation, began to become concerned about future grain price rises and decided to purchase more stocks. The combination of these factors led to the market turmoil of late 1993. Grain prices rose sharply and panic buying began.

Not surprisingly, the government responded sharply to this situation. Several new policies were implemented since late 1994. Government grain procurement once again became compulsory and grain rationing was restored in some areas. Ultimately, the market-oriented reforms of 1993 were eroded. The government showed that it would still intervene administratively in the grain sector. As a result, a provincial governor's "Rice Bag" responsibility system, a decentralisation of the grain system by developing responsibility for local grain balancing to the provincial level, was introduced in 1995. The system is designed to strengthen food security and grain markets by making provincial governors and governments responsible for balancing grain supply and demand and stabilising local food markets and prices. This policy has already contributed to increased output, more stable grain production and a significant reduction in short-run agricultural price fluctuations. However, such a policy is not

without costs. The policy's impact on the efficiency of resource allocation, the diversification of agricultural production, and farmer's incomes should not be ignored.

#### 4 Current grain marketing policies: 1998 to present

After three record levels of grain production in China in 1995-97, almost zero or negative inflation since 1997, increasing grain stocks, and a decline in food prices, China implemented a new grain marketing and stock-holding policy in April 1998. Individuals and private companies are prohibited from purchasing grain from farmers directly. Commercial agencies of grain bureaus and grain reserve system should be the only ones who purchase grain from farmers. Prices of grain sold by grain bureaus should be set at a level higher than procurement prices in order to avoid a loss in marketing by the grain bureaus.

From the very beginning, this grain marketing policy has been debated by economists both at home and abroad. The new grain marketing policies face several major problems. Let us first examine the policy that government grain departments will purchase all surplus grains that farmers want to sell at the protection prices (floor prices), and individuals and private companies are prohibited from purchasing grain from farmers. First, since the 1990s with the implementation of a series of grain marketing reform policies, grain marketing channels have been greatly diversified and the market share of non-state grain agencies (individuals and private companies) in purchasing and selling farmers' surplus grains increased substantially. A combined grain marketing system including state, collective, individual and private grain traders has emerged, which has greatly promoted the integration of the grain market in China.

Therefore, under the new policy not only is it very difficult to prohibit individuals and private companies from purchasing grains from farmers, because they are more economically efficient than state grain departments in doing business, but also it will have a negative impact on grain market integration. Second, the market prices now are not much lower than the protection prices. Even though in some regions the protection prices of some kinds of grains are higher than the market prices, the situation of indirectly reducing purchase prices by lowering the declared grade of grain is a common practice by state grain departments. Third, because of the differences in comparative advantage in grain production among regions, grain production costs are also different among regions. Therefore, the protection prices are not the same in different areas. Even though the local protection prices are higher than the local market prices, individual and private companies still make every effort to buy grains from local farmers and to sell in other regions where the market prices are higher than the local protection prices. Fourth, the transaction costs of the new policies are very high because it relies heavily on administrative methods.

Can the state grain bureaus achieve the goals of avoiding losses in grain marketing through this policy by setting the sale prices higher than the purchase prices? The answer is also debatable. First of all, if state grain departments can not purchase most of farmers' surplus grains, then it will be very difficult for them to sell grains at the prices higher than the purchase prices. Second, because of their market-oriented nature, individual and private companies are more efficient than state grain departments in grain marketing. Therefore, individual and private companies are always able to purchase grains from farmers at the prices higher than the protection prices and sell at the prices lower than the sale prices of state grain departments.

Therefore, no matter how high the protection prices are, individual and private companies will continue to hold a considerable market share in grain sales. Third, since 1995 China has had several consecutive years of good harvest. In the short run domestic supply has exceeded domestic demand, which has then led to the decline of domestic grain prices. In this such situation, state grain departments find it very difficult to realise the goals of buying at lower prices and selling at higher prices. Fourth, because the state grain departments buy more than they sell, they will face more severe financial problems as the grain stock piles up.

## 5 Conclusion

This paper briefly introduced the process of China's grain marketing reform since the late 1970s. It revealed that though 20 years of reform, China's grain marketing system has been greatly liberalised and marketised. Increased income changed the demand for grain from low quality to high quality food grain, which turned consumers from state owned retail stores to the grain market. Most of the grain is now sold at the market prices. The market structure has changed and private business companies and individuals play an active role in the grain business, which promoted the competition and efficiency in grain marketing sector. Despite this progress, China's grain marketing system still retains many characteristics of the centrally planned economy, and government intervention and administrative methods are still the common practices in regulating grain marketing. However, the reforms to date have enabled greater decentralisation and marketisation of the grain marketing system. The pressure for further reforms remains.