

# The Political Economy of the Chinese Grain Marketing System

*Funing Zhong*\*

*Nanjing Agricultural University, China*

## 1 Introduction

The grain procurement and marketing system was established in China in the early 1950s. The primary policy objective was to ensure equal and relatively efficient distribution of limited grain among consumers and industrial users, and to ensure the growth of grain production at the planned rate. At the same time, it was assigned another important task: to divert agricultural surplus into investment in the urban-industry sector, in order to pursue the “heavy industry first” development strategy. The grain procurement and marketing system was empowered with monopolistic procurement of grain at the farm-gate and rationing in the urban areas. While procurement quota was used to ensure the delivery and its growth, the price scheme was used to transform agricultural surplus into industrial profits and government revenues, and hence new investment in the industrial sector.

With procurement price below the market level, such a system might have discouraged grain production in the past decades, and undermined its capacity in serving the stated and intended policy goals in the long run. It was why the 1978 reform started from the rural areas and had extremely significant impact on the grain sector. Following continuing increase in procurement price and other market-oriented reform measures, the role of the grain marketing system in diverting agricultural surplus gradually reduced. When the procurement was set above the market level in the mid-1990s, the implied policy objective of diverting investment funds finally turned to become a stated one: “protecting farmers against low price in the market”.

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\* Professor and Dean, College of Economics & Trade, Nanjing Agricultural University, Nanjing, China.

However, as such price support proved too costly, the government tried very hard to balance between the stated policy goals, especially food security, and the resulted budget burdens, and looked for alternatives in further reform.

Bold reform measures towards market-oriented direction were taken in 1985 and 1993, when grain supply was in surplus, and setback occurred when grain supply was tightened. The twist was quite consistent with the primary policy objective, i.e., set for the state grain system, and as the administrative measures carried out by the grain system was the most familiar and probably most reliable policy tools for the government during the past decades. It was just trying to learn other alternatives, and probably more efficient ones, in achieving the same policy goals.

As China is now facing more apparent surplus in domestic grain production, the market-oriented reform of the grain marketing has been once again a hot topic in the policy arena. The interests in the discussion have been strengthened by the expectation of China's accession into the WTO, which will obviously challenge the monopolistic grain marketing system operated in China, in addition to the state trading scheme.

This paper tries to address policy issues with China's grain marketing system in historical perspectives, and provide a political economy analysis to the objectives, implementations of and constraints facing the system. Finally, a brief discussion on possible further reform of the system is presented.

## 2 Grain Marketing System Prior to the 1978 Reform

Food security was the core of the Chinese grain policy. The rationale of the state involvement in grain marketing was rooted from the experience of the war times, as well as that from successful controlling inflation during the early 1950s. Of course, the state monopoly in grain marketing was also consistent with the planned economy, and could be used as a convenient tool to collect funds from the rural areas to be invested in the industrial sector. However, the two objectives were somewhat in conflict with each other, and the policy proved to be unachievable, even self-defeating to some

extent after about 25 years in practice. This could partly explain why the 1978 reform started in rural policies and the initial measures in the reform were mainly concerned with grain production and marketing.

## **2.1 Roots of the “Unified Procurement and Marketing System”**

Although the state monopoly procurement of grain was formally introduced in China in late 1953, the involvement of the Chinese government in grain marketing started well before that. It could be dated back to the period of the Third Civil War (1946-49) as a kind of wartime measure, but soon was given other policy objectives, such as anti-inflation and industrial development.

During the World War II and the subsequent civil war, China suffered severely from inflation. It was reported that, with the same amount of money, one could buy one beef cattle in 1936 but only two grains of rice in 1949. According to Xu, the general price index increased by 2.5 million times from 1937 to 1948 in Chongqing City, the national capital during the World War II. The situation was not improved after the World War II. As one of the indicators, the price of rice in Shanghai, the largest City in China, increased by 43.7 times during the first eight months of 1948 (Xu, 1983). This extremely high inflation rate was a major force contributing to the overthrow of the Guomindang government.

When the People’s Republic was established in 1949, one of the first tasks for the new government was to stabilise prices, especially in cities. This was considered crucial to the final success of the new government in the whole country. As the expenditure on food was the dominant part of living expenses in a poor country like China after 10 years of wars, if the price of food could be controlled, so could the inflation. By re-distribution of land to individual peasants through land reform program, the new government had won the support of the majority of the rural population. With the strong political support of farmers and the rapid recovery in agricultural production, also largely stimulated by the land reform, it was not very difficult for the government to acquire a large quantity of surplus grain and re-sell it in cities at low prices (“list price”) at that time. According to Walker, the government’s role in grain marketing had been increased in the early 1950s, although much of the grain was still marketed

by private merchants (Walker, 1984). In 1952, the government collected 19 million metric tons (mmt) of grain as in-kind agricultural tax, and purchased another 13 mmt. The total quantity acquired by the government was about 63 percent of the market needs in the urban areas.

However, like any other economic activity, grain marketing could not rely on political enthusiasm for long time. As Walker pointed out, the gap between the state “list” price and that offered by private merchants was widened to about 20-30 percent in the early 1950s. As a result, state grain agencies found it more and more difficult to buy grain from farmers at their “list” prices. Therefore, a new marketing institution must be established in the grain sector.

A more important factor was the fact that China started its “First-Five-Year Plan” in 1953 that marked a new strategy in national economic development. The core of the strategy was to build up a heavy industry sector in a short time period, with the long run objective of speeding up economic growth through steadily investing a relatively larger share of the national income into the producer goods sector. To achieve this goal, the government believed that it was necessary to control the allocation of the national income between consumption and capital formation, at least to raise investment funds to the extent it desired. In the industrial sector, most large enterprises were already owned by the state through the nationalisation of foreign capitals and confiscation of bureaucratic ones at that time, and most small private enterprises were brought under state control in the form of “joint state-private ownership,” so the government could control the allocation of national income directly. But, the private (and later the collective) ownership in the agricultural sector gave the government little role in revenue allocation to the extent it desired. As raising agricultural tax was not politically desirable, the only alternative left was using price and marketing scheme. Ideally, such scheme should be able to convert agricultural surplus into industrial investment through widening the price gap between industrial and agricultural goods, and the resulted accumulation of profits in the state-owned enterprises.

In order to do so, the new marketing system must be able to control price by eliminating competition at farm-gate. Moreover, it must be able to acquire adequate

supply at low price, and distribute limited supply to consumers with relatively strong demand at low price more or less equally. To meet all these requirements, a state monopolistic and compulsory “unified grain procurement and rationing system” was designed and established. The fundamental of the system was to divert agricultural surplus into industrial investment through administered low price, while ensure the quantity procured and distributed through quota and rationing, respectively.

The “unified grain procurement and marketing system” alone might not be adequate to ensure grain production increase at the desired speed, as the price was too low to stimulate the production. Therefore, administrative measures such as production and sown area plans were used to determine allocation of resources between grain and other production. The collective farming established in the mid-1950s and the subsequent communal system made the government control over resource allocation among crops easier, which might have contributed to the relative success of the development strategy at the beginning. However, the grain marketing system and the communal system were later proved inefficient in terms of resource utilisation as well as allocation in the long run, and the so-called “heavy industry first” strategy was proved incapable to achieve its objective.

## **2.2 Basic Features of the System**

Prior to the reform, all farm products were classified into three categories by the government according to their importance in people’s life and economic development. The goods in the first category included grain, edible oil and oil-bearing crops, and cotton. The second category goods were major animal products, tea, silk and sugar. All other farm products were grouped into the third category. Different institutional arrangements were set for the three categories of farm products in the marketing systems.

At farm-gate, or from producers’ point of view, the goods in the first category, including grain, edible oil and oil-bearing crops, and cotton, were subject to so-called “*tong gou*”, or “unified procurement.” The government was the sole buyer of goods in this category, through the compulsory quota system. Basic quotas were fixed for a 3 to 5 year period along with production targets, and procured at quota prices. Above

quota deliveries were related to production exceeding the target levels, and also compulsory, usually procured with a 20 to 30 percent premium above the quota price. Those goods were not allowed to sell on free market, and the surplus, if producers were willing, could be sold to the government at “negotiated price” also unilaterally set by the government.

The goods in the second category were subject to “*pai gou*”, or imposed purchase, and consisted of meat and aquatic products, tobacco, tea, silk, and sugar crops. The government set compulsory procurement quotas and the corresponding prices for those products, but permitted sales on free market after producers having fulfilled their delivery obligations.

There were no compulsory quotas for the goods in the third category, mainly consisted of vegetables and fruits, and some industrial crops. However, as long-distance trading was not permitted for producers, government agencies had dominant power in marketing those goods, especially in industrial crops, and hence were able to set price to a large extent.

The “unified marketing” consisted of rationing to consumers and planned supply to industrial users. At the retail side, or from consumers’ point of view, grain, edible oil and cotton were rationed by the government and supplied by state agencies. All formally registered urban residents were entitled to monthly rationing of grain and edible oil with the quantities determined by their age and occupation. Some farmers who were basically engaged in cash crop and/or other non-grain production, or their long run grain production was considered far below a certain level determined by the government, may also be entitled to grain rationing. Coupons were issued by local grain agencies under the rationing system, which could be used to buy grain and edible oil at a designated state grain store, or buy processed food products at groceries or any shops, or eat at restaurants. While meat was also subject to monthly rationing, cotton was rationed annually; both were sold on coupons.

Industries using grain as their major input, such as food processing, feed processing, textiles, brewing, pharmaceuticals, etc., as well as restaurants and food stands, were dependent on state supply of the grain they needed, as there was no other market for

the input. The supply to each individual industrial user was determined along with its production plan or “target,” and at the fixed “planned” price.

### **2.3 Evolution of the System**

On October 16, 1953, the Central Committee of the Chinese Communist Party released a document entitled “Solution on Implementation of Planned Purchase and Planned Supply of Grain”, which gave monopoly power to state agencies over grain marketing. Under this system, the state grain department was the sole buyer and seller of grain. A delivery quota was assigned to each individual farmer (later on to each collective, or production team under the communal system), specifying how much grain must be sold to the state agency at a given price. As mentioned above, if a farmer household mainly engaged in non-grain production or lived in a place where grain production was far below some officially recognised level, a certain quantity of grain supply will be assigned to the family.

The quantity of delivery quota was initially set according to an assessment of the harvest for each producer. As it was extremely difficult to assess harvests accurately, and as farmers did not wish to produce and deliver more grain at low price, a “*sanding* (three-fix)” scheme was introduced in the spring of 1955. The “three-fix” referred to fixing the output target, the associated procurement quota, and in some cases, the grain supply. Under the “three-fix” scheme, the quantities of output target, procurement quota, and possibly supply were made known before planting and would not change after harvest, except in the event of a severe disaster. Those quantities were first fixed for three years, and later on extended to five years. The quota procurement was usually referred to as “*dinggou* (fixed quota purchase)”. Technically, the total quantity of “*dinggou*” included a certain part of delivery as in-kind agricultural tax. However, this difference only had influence on how much would be deducted from the cash payment to grain delivered, no any impact on the quantity of delivery at all.

As the demand for grain increased over time, the government had to increase its procurement. Since the quota was fixed for several years, the state introduced “*chaogou*”, or “above quota purchase” in 1957. At that time, the quantity of above

quota purchase was set in the spring each year, in the light of possible “over production” above the pre-set output target. This above quota purchase was said to be “obligatory”, not compulsory, with the delivery relying on persuasion. From 1957 to 1972 the state agencies paid the same price for the “fixed quota purchase” and “above quota purchase”. As the later was not compulsory, the state found it increasingly difficult to acquire the desired amount despite the pressures it exerted on producers as “persuasion”. Therefore, a price premium of 20-30 percent was introduced to the “above quota purchase” in 1972, to provide certain incentives for the delivery. This above quota purchase was further made compulsory in later years, with the quantity fixed as 30 percent of the difference between the actual production and the pre-set target. At the same time as the price premium was introduced for the “above quota purchase”, the government initiated another category of grain procurement: “*yigou*”, or “negotiated purchase”. Producers were relatively free to make decision on selling grain in this category, and the price paid was more flexible, sometimes higher than that for the “above quota purchase”.

The rationing system started in the urban areas in August, 1955. Grain coupons were issued to each urban resident with the amount determined according to one’s age and occupation. Usually grain coupons were area specific, could be used only in local state grain shops, food stores, and restaurants. A kind of nationwide coupon was also in use to facilitate travelling, but it should be substituted for the area specific coupon, and sometimes proof of official business travelling was required for the substitution. Grain coupons were issued monthly. Determined by local authority, the coupons could be used any time once had been issued, or valid only in the month, or during the rest of the year. In many areas, the coupons were grain specific, so several types of coupon were issued each month.

In the rural areas, the planned supply of grain was provided to certain farmers as a component of the “three-fix” scheme. Once the grain output target had been set (fixed), a producer would be required to deliver certain quantity of grain to state agencies (fixed by quota). Or, the producer might be entitled to “fixed” (planned) supply, if the expected grain output was far below some officially set standard either due to harsh production conditions, or as the farmer being engaged in other production. In the later case, the quantity of planned supply might be set in relation to

the quantity of cash crops delivered to state agencies. The planned supply in the rural areas was provided at the same price as that for rationing in the urban areas.

The rationing system, along with the planned supply to industrial users, basically unchanged during the whole 1955-78 time period, and was dominant grain marketing channel at that time. Generally speaking, free market, such as country fairs in the rural areas and the open market in the urban areas, played minimum role in grain transaction during that time as consumers' basic needs were met by the rationing system. The quantity of grain traded in free market depended on the overall situation of food supply from the government channels in the urban areas, and the extent to which farmers might change their production structure in the rural areas, as well as the consumers' income level at the time. Sometimes, such as during the "Cultural Revolution", sales of grain on free market were even made illegal.

#### **2.4 Situations in the Eve of 1978 Reform**

As briefly outlined above, the "unified grain procurement and marketing system" was one of the measures to speed up the industrialisation process in China. Following the "Heavy Industry First" strategy initiated by the Soviet Union, it was believed that by expending the share of capital formation in the total national income and investing more than proportional in the heavy industry sector, the growth of national economy could be speeded up. The "unified grain procurement and marketing system", along with the sown area and production plan, was used to ensure adequate food supply at low price to support the industrialisation process, and to add fuels to the process by diverting agricultural surplus into industrial investment.

The underlining logic was that the economic growth depended on capital formation in a country with abundant labour force like China. In this case, if more national income could be used as new investment, faster growth would be achieved as the production capacity was expended faster. Furthermore, if the new investment was allocated in the way that the heavy industry (the producer goods sector) obtained its share more than proportional, the output in the sector would be able to increase faster than the whole economy, resulted in accelerating growth in production capacity in the sector. This would lead to even faster growth in the producer goods sector first, and in the whole

economy later. It was well recognised that the growth in the light industry and agricultural sectors (the consumer goods sectors) would slow down under such development strategy. However, it was strongly believed that this would happen only in the beginning of the development. As the heavy industry was to grow faster compared with what might be under any other development strategy, so would be the growth of production capacity, first in the producer goods sector and later in the consumer goods sector as well. Therefore, the growth of the consumer goods sector would start from a low level, then would be accelerated and finally would be able to catch up with that in the heavy industry sector. In general, the growth of the two sectors was to be accelerated continuously, though started at various rates and accelerated at different speeds.

However, it was not the case in reality. The consumption level and its growth rate were kept low as planned: per capita consumption increased at 1.7 percent in the rural areas and even less in the urban areas during the 1965-78 time period.<sup>1</sup> As a matter of fact, the growth in urban consumption was achieved through an increase in the number of workers per family, the real wage rate actually declined by 12 percent on average during the time period. But the growth of the whole economy, even that of the heavy industry sector itself, did not accelerate as expected. Actually the growth rates were fallen continuously in all sectors. During the “First Five Year Plan” period (1953-57), the total output value increased at an annual rate of 11.3 percent, while the national income and consumer goods increased at 8.9 percent and 6.5 percent per year, respectively. However, after recovered from the 1959-62 crisis, the growth rates of the total output value, the national income and consumer goods declined to 9.3 percent, 8.3 percent, and 5.0 percent, respectively during the “Third Five Year Plan” period (1966-70). The growth rates declined even further to 7.3 percent, 5.5 percent, and 4.9 percent, respectively during the “Forth Five Year Plan” period (1971-75).<sup>2</sup>

This outcome was obviously contrary to the expectation presented by the “Heavy Industry First” development strategy. Many factors might have contributed to the slow down of the growth rates, and the low level of consumption and its slow growth were likely to have major impact on the outcome. The slow growth in consumption,

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<sup>1</sup> 1965 was the year China fully recovered from the crisis in 1959-62 time period.

<sup>2</sup> Growth rates are calculated from data presented in [China Statistical Yearbook](#), various issues.

especially the decline in real wage rate, might have had negative effect on work incentives, and the resulted loss in production efficiency might have outweighed the increase in capital formation. This point of view was soon supported by evidence during early years of the coming economic reform.

The failure of the strategy led to a nationwide debate on the purpose of social production in the late 1970s and early 1980s when the political environment became more favourable. Most economists in China criticised the previous development strategy as being “production for its own sake”, and preferred more balanced growth among all sectors. Policy makers responded with allocating more resources to the consumer goods sector, and providing more material awards to good performance in work, in order to improve people’s living in general and to stimulate production incentives in particular.

The existing grain marketing system was recognised unable to serve the new policy objectives. The system could not encourage farmers to produce and deliver increasing quantity of grain to state agencies at the low price in order to meet the increased demand, and the pressure to divert agricultural surplus through the system was reduced to a large extent. These two factors shaped the beginning of the process reforming the grain marketing system started in the late 1978.

### 3 Grain Marketing System in the Process of Reform, 1979-98

The initial reform in the grain marketing system, accompanied with other institutional changes such as the “Household Responsibility System”, brought rapid growth in the grain and the whole agricultural sectors in a few years. The great success eased the tension in ensuring food security to some extent, and led to further market-oriented reforms in the grain marketing system, sometimes on experiment bases. During this time period, partly due to the rapid growth in the industrial sector and partly due to the reform of the grain marketing system itself, the role of funds diverting was gradually reduced to a negligible level, while a new role of price supporting emerged to some extent. The evolution of the system after the mid-1980s more or less marked by the conflict between the stated policy goals and the efforts to reduce the budget

burdens.

### **3.1 From “Unified Procurement” to “Contracted Purchasing”**

The reform started in December 1978 had several components in the grain procurement and marketing system. Firstly, the procurement price was to increase by 20 percent on average in 1979, compared with a total increase of 13 percent in previous 15 years. Moreover, the price premium for the above quota delivery was to increase from 30 percent to 50 percent of the quota price at the same time. As the quota quantity was gradually decreased over years, the proportion of grain sold on above quota delivery continued to increase, and so did the weighted price. Obviously, the big increases in both quota and above quota prices would be a substantial improvement in stimulating production incentives.

Secondly, local and producers’ autonomy in decision-making was formally acknowledged by the central government. In the agricultural sector, the sown area plan and the production target were no longer compulsory. Although the pressures to follow the “guild line” were still quite heavy on local community and producers, nevertheless, they were able to allocate or re-allocate resources according to their own choices to a certain extent under the new policy. It was quite likely that the efficiency in resource allocation might be improved as a result, and so was the yield in grain production.

Thirdly, grain trade in free market such as country fairs in the rural areas and open market in the urban areas was formally legalised at the beginning of the reform, and soon non-government and private traders were permitted to do their business in grain wholesale and long-distance shipment. As a result, the number of free markets increased very fast in both rural and urban areas in a few years. At that time, the free market price in most cases was higher than the above quota price provided by the state agency, and the increasing number of free market provided farmers with greater and better opportunity to sell their increased output stimulated by the new policy. Therefore, the development in market not only improved farm-gate price and farmers’ income, but also stimulated grain production further.

Combined with another major institutional change, namely the establishment of the Household Responsibility System (HRS), the initial reform in grain marketing system had achieved remarkable success during the first 6 years in terms of boosting agricultural production in general and grain production in particular, as well as increasing farmers' income. From 1978 to 1984, the total grain output increased from 304.8 mmt to 407.3 mmt, or 4.95 percent per year. Per capita net annual income in the rural areas increased from 133.6 yuans to 355.3 yuans at the same time in nominal terms, and the annual growth rate was estimated at about 15.8 percent in real terms.<sup>3</sup>

The great success in the grain sector, as well as that in the whole agricultural sector, was consistent with the policy objective set for the reform: to stimulate long run fast economic development through more balanced growth between producer goods and consumer goods sectors, and through the associated improvement in people's life. As mentioned above, farmers' net income increased remarkably in real terms. On the other hand, because the government did not raise retail price for rationed grain (and for other state-marketed foods in the first a few years), urban residents enjoyed low expenditure on food and other necessities while their income continued to increase quite significantly.

However, this situation inevitably led to increasing burdens on the government budget. The "unified grain procurement and marketing system" was not set for revenue generation per se, the income transfer was realised as profit owned by all state-owned enterprises from the associated low labour costs. Therefore, and partly due to the low labour costs resulted from its own operation, the system itself was generally run on non-profit basis. Following large increase in quota and above quota prices in procurement, and the subsequent increase in its own labour costs, the deficit increased very fast in the early 1980s. It was reported that, the government budget to grain and edible oil marketing had been 3.63 billion yuans or 3.24 percent of the total budget expenditure in 1978, and soon increased to 20.5 billion yuans and 13.65 percent, respectively, in 1984.<sup>4</sup> If other budget expenditures on agriculture included, the total government subsidy to agriculture was 48.5 billion yuans and 32.3 percent, respectively in the same year (the total subsidy to agriculture was even higher in 1981

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<sup>3</sup> Figures are calculated from data presented in China Statistical Yearbook, various issues.

<sup>4</sup> Source: China Statistical Yearbook, various issues.

and 1983, as it exceeded 40 percent of the total budget expenditure). It seemed very clear that this situation could not last any longer.

Following 6 years' bumper harvests, China faced big surplus in grain supply for the first time. Many farmers in major growing regions complained the "difficulty in selling grain" partly due to the insufficient handling capacity, and partly due to the reluctance of government agencies in buying the whole surplus offered by farmers, especially when local authorities had faced budget burdens in doing so. The continuing fast growth in grain production and the huge surplus led to some policy changes at the top level. Instead of pushing grain production continuously, more arable land was encouraged to grow other crops, and uses of grain other than that for direct human consumption were strongly encouraged as well at the time.

The budget burden and the huge surplus in grain production provided very favourable policy environment for reforming the 30-year-long "unified grain procurement and marketing system", and new "contracted purchasing system" was designed and put in effect in 1985. Under the new system, procurement quota was substituted with "purchasing contract", which would be less compulsory compared with quota. This "purchasing contract" was not a real contract as understood by business circle, as both the price and quantity were unilaterally set by the government.

In 1985, the price for the quantity delivered according to the contract was set as a weighted average of the quota and above quota prices in 1984. As quota delivery had accounted for only 30 percent and above quota accounted for 70 percent in the total, and also as the above quota premium had been 50 percent of the quota price in 1984, the new "contracted purchasing" price in 1985 was equal to 135 percent of the previous quota price. However, this price was only equal to 90 percent of the above quota price, and farmers would get price equal to the previous quota one for any delivery in excess to the contracted amount. This implied that farmers would be paid less for any incremental grain delivered to state agencies. In other words, the marginal return to grain production was purposely depressed to a significant extent.

The big reduction in the marginal price immediately had significant impact on grain production, resulted in 7.4 percent drop in total output in 1986. Compared with 4.95

percent annual increases for the previous consecutive 6 years, this big drop appeared to be dangerous signal that grain supply might be in short once again, and hence food security should be addressed by more rigorous policy. So, after only one year, the “purchasing contract” was announced “state contract”, hence compulsory for every producer. Such “contracted purchasing system” was basically unchanged until 1993.

To some extent, the twist in the reform of the grain marketing system in the mid-1980s marked the characters of the reform in the following decade. Any step towards more market-oriented direction depended on how comfortable the government felt with the actual and expected total supply, and how heavy was the budget burden to maintain the existing marketing system.

### **3.2 Changes in Rationing and Planned Supply**

The reform of Chinese urban-industry sectors started with “dual price track” in the early 1980s. Under such institutional arrangements, every enterprise was entitled to get certain quantities of inputs at administered low prices in order to produce the “planned” output, which was to be sold at administered low price as well. For the above-target production, prices for both inputs and outputs were to be at market or “negotiated” levels. This was gradually applied to industries using grain as their main input.

Encouraged by initial success in the reform, the government took bolder measures in reforming the urban-industry sector by relaxing price control on most consumer goods. Such measures might serve two policy objectives: 1) to push the reform further towards the market-oriented direction; and 2) to control and reduce the burdens on government budget. As a part of the efforts, in 1985, the government formally announced its decision to abolish planned grain supply to all industrial users including food and feed processing, textiles, brewing, pharmaceuticals, etc., as well as restaurants and food stands. They had to buy grain from state agencies at “negotiated price” to cover the costs, or directly from free market. Of course their products were permitted to sell on free market or at market prices.

The government did not raise urban retail food prices during the early 1980s, even in

the face of rising procurement prices. According to the 1990 Price Statistical Yearbook of China, retail price for rationed grain in urban state shops increased by 6.3 percent from 1978 to 1980, and by 9.9 percent from 1980 to 1985. As the price was an average weighted by various varieties, the increase might basically reflect changes in composition and qualities, not price level. Then, suddenly, the retail prices for rationed grain and edible oil in the urban areas were raised by 20.9 percent in 1991, and another 39.2 percent in 1992, bringing the rationed retail price equal to the procurement price and leaving the government to subsidise only the associated marketing costs. As a result, the retail price for rationed grain was only slightly below the level prevailed in free market in 1992 and afterwards. This difference in prices at various markets might just present the difference in quality, so grain provided from the two channels became perfect substitutions for each other by that time. With further growth in the number of free market and volumes traded in free market, consumers were able to make free choices, depending on his income and preference. In other words, the rationing of grain and edible oil was no longer binding. Actually many local authorities abolished the rationing in 1993 by terminating their obligation to provide fixed quantity of grain to local residents at fixed price.

The increase in retail prices for rationed grain clearly indicated the government's intention to cut budgetary deficit resulted from the subsidy to urban residents. It also reflected the government's confidence that the increase in food price would not lead to any political problems as per capita income had been increased significantly in the urban areas in the past 10 years. The urban consumers calmly accepted the new price as expected, though the total increase was quite remarkable, about 70 percent in two years. However, the budgetary burden did not reduced, at least not to the level as expected. As more and more urban consumers turned to free market, the unit operation cost went up with decreasing volume sold by the state agencies. In addition to the marketing costs, including increased storage and interests costs, there might be big potential losses due to unmarketable grain after being stored overtime.

The inevitable losses in the grain marketing system had been well known for a long time, and the government subsidy had been considered necessary for food security reasons. This had been politically acceptable to almost every one, as the deficit had been mainly the difference between high procurement price and low retail price. Such

deficit had been recognised as “policy deficit”. However, following the retail price increase, suddenly, the deficit incurred in the state grain marketing system as a whole appeared to be “operational” in its nature. It became more and more to tolerate the huge and increasing deficit as for policy’s sake, and calls for bold reform, including totally free grain marketing, came from various groups in the country.

As the state involvement in grain marketing was still considered the last, and probably the most reliable, measure to ensure food security, the government was reluctant to abolish the state grain marketing system completely, although most urban consumers might have relied on free market for grain supply. All later changes in the reform process were efforts made by the government in struggling between maintaining its perceived food security objective and reducing, if not eliminating, deficit in keeping the grain marketing system. It was hoped that the state grain marketing system would improve its operation and hence reduce its deficit during subsequent reforms, and the pressure to reform the system itself continued to increase.

### **3.3 The 1993 Price Surge and the “Governor Responsibility System”**

On February 25, 1993, the State Council announced a new policy commonly known as “*baoliang fangjia*”, i.e. fix the quantity while free the price for “contracted purchasing” of grain. While farmers were still obliged to deliver a specified quantity (quota) of grain to the state agencies, the price was to be at the market level. Same as before, selling onto the free market was allowed once delivery obligations had been fulfilled. As mentioned above, more and more local authorities announced freeing grain retailing under their jurisdiction.

However, the government failed to specify what market price should be used for procurement purposes, and by what date farmers had to fulfil their delivery obligation. The vagueness of this policy created problems for both producers and consumers. Unfortunately, China had suffered from double-digit inflation since 1992. When faced with another run of rapid inflation, farmers withheld grain deliveries in the fall and winter of 1993-94, anticipating higher prices. Local governments in surplus areas responded by prohibiting outward grain shipments to enforce the “quota delivery first” policy, but the real objective was to reduce their procurement expenditures. This

contributed to a substantial escalation in grain retail prices in urban areas. The government reintroduced urban retail price controls and, in many regions, reintroduced a fixed purchasing price for grain.

The market price increases in late 1993 and the 2.5 percent decline of grain production in 1994 were viewed by the government as a signal that more rigorous administrative control was necessary. It was announced and/or re-emphasized, at the end of 1994, that non-governmental agencies were not allowed to buy grain directly from farmers, especially when the contracted purchasing quota had not yet been fulfilled, and that government agencies should prevail in the grain market. A “temporary” blockade on rice and corn exports was imposed in late 1994. In addition and above all, under a newly introduced “Governor Responsibility System”, all provincial governors were made personally responsible for grain production and supply under their jurisdiction, and prices were not to be raised without central government permission.

Driving provincial governors to increase grain production, while at the same time prohibiting price increases, was clearly a setback of the reform. China’s central government was facing a difficult policy dilemma. The experience over the past 15 years clearly indicated that market-oriented reform was the major force driving economic and agricultural growth. Yet the government still did not trust the market mechanism and relied on administrative measure to ensure food security, and was still reluctant to give up on the long-term development strategy of pursuing industrialisation at the cost of agriculture. A low cost supply of grain was at the core of this strategy, and administrative measures were consistently used to achieve this goal, unless a crisis made a price increase the only way to stimulate production.

### **3.4 Call for Further Reform: the Situation Since the End of 1996**

There was a very significant change in Chinese grain balance during the 1993-96 time period. As mentioned before, the sudden increase in market price in the late 1993 and the decrease of grain production were taken as a warning signal of possible food shortage in the coming years. At the same time, the inflation reached double-digits in 1993-95 following a big increase in nominal wage rate in the urban areas, resulted in

further increase in food prices. Under such situations, and fuelled by the debate led by Mr. Lester Brown, the Chinese government responded with raising grain price for the “contracted purchasing” to a big margin. From 1993 to 1996, the state-set “contracted purchasing” price for grain was increased by more than 100 percent on average. Accompanied with relatively rigorous administrative measures labelled by “Governor Responsibility System”, such increase in procurement price resulted in consecutive bumper harvests in a row.

However, the demand for grain, and for food in general, did not increase during the same time period. According to household survey, per capita consumption of almost all food items was kept constant, or even declined, during the first half of the 1990s, especially in the urban areas, despite average income continued to increase. There were several explanations why food demand did not increase with per capita income during that time period.

Firstly, China’s income disparity widened after the initial stages of the reform, and this might have had an important impact on grain consumption and on food consumption in general. According to He et al., the Gini coefficient was 0.16 and 0.24 for the urban and rural population respectively in 1980. However, it reached 0.31 and 0.33 respectively in 1995.<sup>5</sup> More specifically, the Urban Households Survey Team of the State Statistical Bureau indicated that, in 1996, 37.5 percent of their sampled urban households had less income compared with the previous year. This situation was even worse among low-income families. According to the same survey, among the 20 percent of the lowest-income households, the percentage of families with declining incomes increased to 53.7 percent, i.e., more than one-half of the low-income families earned less in 1996 than they did in 1995.<sup>6</sup>

Although the Survey Team did not specify whether the above income data were nominal or real, it was likely that they were measured on a nominal basis. Elsewhere, it was reported that in Jiangsu, one of China's most prosperous provinces, 25.1

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<sup>5</sup> He et al. "Dui Dangqian Shouru Fenpei de Toushi (A Perspective of Current Income Distribution)", *China Statistics*, Feb., 1997.

<sup>6</sup> Urban Household Survey Team, State Statistics Bureau. "1996 Nian Chengzheng Jumin Shenghuo Shuiping Wenbu Tigao (The Living Standards Steadily Improve in 1996 for Urban Residents)", *Statistical Data*, April 10, 1997.

percent of urban families had less income in 1996 than in 1995 in nominal terms, and the same figure was 42.4 percent in real terms.<sup>7</sup> If the same trend was applied to the national statistics, probably more than one-half of urban residents had less income in 1996 compared to 1995 in real terms, and such percentage might be even larger for low-income families. In any case, incomes were falling for a large percentage of families in China, inevitably resulted in weakened demand for grain and food.

Secondly, the progress in the market-oriented reform required a larger share of disposable income to be used for housing, medicare, and education, as well as contribution to pension, unemployment, and other social security programs. As the unemployment rate continued to increase and the income expectation for the future went down for many families, such increasing deduction in current income must have resulted in cutting current consumption including food to a large extent.

Thirdly, several structural changes in the economy might have reduced food consumption. From 1985 to 1996, the share of labour employed in the primary sector declined from 62.4 to 50.5 percent, while the share in the tertiary sector increased from 16.7 to 26 percent. As more and more labour force had shifted from the agricultural and industrial sectors to the service sector, their physical workload might be reduced, led to lower caloric requirements in the daily diet. Even within the agricultural sector, farmers did not have to work as hard as under the communal system. It was reported that, instead of working more than 300 days a year in the 1960s and 1970s, farmers worked only about 60 days in the 1990s, their caloric intake was likely to reduce as a result.

The accumulated imbalance between grain supply and demand led to an unexpected sharp drop of grain price at the end of 1996, about 40 percent in a month across the whole country. To everyone's surprise, after only two year from the debate led by Brown, the surplus in China's grain production was proved real and for quite a long time. Even called for by the government to shift resource from grain to other crops, and resulted in decline in almost all farm prices as the surplus spread over all sub-

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<sup>7</sup> Sutong (Jiangsu Provincial Statistics Bureau). "Wosheng Jumin Jiating Jianshou Zhuangkuang Haozhuan(The Household Income Declining Situation Is Improving in Our Province)," *Fuwu Daobao(Service Herald)*, Dec. 27, 1997

sectors in agriculture, grain price remained at the low level for years without any indication to rise. Farmers complained for the declining price and income, as an increasing share of their output, including grain in above to the “contracted” quota, was sold at low and decreasing prices in the market. The government responded with establishing a “protective” price for grain in the case of above quota delivery to state agencies, which was lower than the quota price but higher than the market one.

The state grain agencies were then put in an awkward position. In addition to the formal obligation to procure quota grain at the pre-set “contracted purchasing” price, which was much higher than the market price, they were requested by the new policy to be the last buyer of all surplus grain at a price higher than that prevailed at market. It was impossible for the state agencies to cover full costs from re-sale of the grain procured at such high prices. As a result, the deficit hiked in a few years.

According to Zhang et al., the total deficit accumulated from April 1, 1992 to March 31, 1998 was 214 billion yuans for the grain agency as a whole (Zhang et al., 1998). As preliminary audit revealed in August 1998, more than 120 billion yuans occurred as the real deficit related to operation, more than 80 billion yuans were misappropriated for other purposes, and the rest more than 10 billion yuans were permitted to be deducted from the balance sheet.

The operation deficit mainly came from the difference between high procurement price and low marketing price, and hence was not a new phenomenon. It occurred first time in 1979 as the procurement price increased by 20 percent (and the above quota price, even higher) in that year. The annual operational deficit reached its peak of 24 billion yuans in 1991, but soon significantly reduced as the result of the increase in retail prices in consecutive two years (it was supposed to be eliminated by the increase in retail price). However, the annual operational deficit had increased to a big margin since 1996 following the increase in procurement price, and jumped to 48.8 billion yuans in 1997 and 29.1 billion yuans in the first quarter of 1998. Another main reason for the operational deficit was the burdens of over-staff in the state grain system. It was reported that more than 4 million employees and pensioners obtained their wages and pensions in the system, but only 1 million were actually working in grain procurement and marketing. The excessive labour costs, plus the deficit

occurred in other business run by the grain system in order to provide employment for excessive staff, accounted for a certain share of the total deficit.<sup>8</sup>

Although the state grain system might be able to operate relatively well during the first 30 years when grain supply was generally in short and it was able to monopolise grain marketing, it was certainly unable to compete with other players in the market. The situation was even worse when grain supply exceeded demand and it was requested to implement other policy to deal with the surplus. Further reform of the system once again became a hot point in academic community, and in policy-making bodies. Many proposals were made, from completely freeing the market to much less liberal measures. No matter what were the specific objectives and associated policy measures for each proposal, it seemed to be a consensus that the system must be reformed substantially.

#### 4 The 1998 “New Policy”

Surplus in grain supply was generally viewed as a precondition for market-oriented reform of the marketing system, and might actually lead to bold reform measures as were the cases in 1985 and 1993. However, the accumulated budgetary deficit since 1992 played a very important role in 1998, as the “New Grain System Reform Policy” was actually aimed at strengthening the monopolistic power of the state grain agencies. To some analysts, the new policy was just a temporary measure, trying to re-cover the deficit with monopoly profit. The market-oriented reform would start again once the deficit had been covered, or the policy goal proved unachievable. The practice indicated that the food security goal was in conflict with price supporting goal, unless the government was willing to incur huge and ever-increasing budget subsidies. It was impossible to transfer the policy costs to consumers, at least in the existing form of the marketing system. Therefore, the 1998 policy would be replaced by other measures, preferably more market-oriented reforms.

##### **4.1 From “Four Separations and One Perfection” to “Three Policies and One Reform”**

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<sup>8</sup> See Cover Story of the *Securities Market Weekly, Monthly Financial Edition, October 1998*, by Zhang et al..

The State Council held a meeting, from April 27 to 29, 1998, to discuss issues related to further reform of the grain marketing system. The basic principles for the future reform were set at the meeting as “Four Separations and One Perfection”, i.e., the separation of grain purchasing and marketing enterprises from government administration, the separation of grain reserves from business operation, the separation of new deficit from old ones, the separation of responsibility of the central government from those of local administrations, and the perfection of price formation mechanism.

According to the document released by the State Council,<sup>9</sup> the deficit occurred before March 31, 1992 (the old) should be separated from that occurred between April 1, 1992 and May 31, 1998 (the new), with each applicable to different methods in paying back, and no deficit was allowed from June 1, 1998. The central government acknowledged that the deficit before 1992 was mainly due to retail price being lower than the procurement one, and was willing to bear burdens of such “policy deficit” from its own budget. However, the deficit after 1992 was regarded as “operational”, as the retail price had been raised to the level adequate to cover procurement price and necessary marketing costs. Therefore, the state agencies, and the local governments in charge of daily operation of those agencies, were held responsible for paying back the deficit from possible future profit by those agencies and/or from the budget of the respective local governments. The document stated that the state grain enterprises should be prepared to pay back all the deficits incurred after 1992 with their own revenues within 5-10 years.

It was stated in the new policy that the grain price would be determined mainly by market forces during “normal years” and the state agencies should operate at the price prevailed in the market. In case of good harvests, the state would set a “protective” price to procure all surplus provided by farmers. The government was to set ceiling price to protect consumers under opposite conditions. It was stressed that “grain risk funds” should be established at both the national and provincial levels to cover any possible deficit related to achieving policy goals, presumably the objectives set for

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<sup>9</sup> “Guowuyuan Guanyu Jinyibu Shenhua Liangshi Liutong Tizhi Gaige De Jueding (The State Council Resolution on Furthering the Reform of the Grain Marketing System)”, May 10, 1998.

protective and ceiling prices.

To most analysts, the “four separations and one perfection” policy seemed to be aimed at furthering the market-oriented reform in the grain marketing system. However, it soon turned to be the opposite as the “three policies and one reform” scheme was formally put in effect with concrete measures in a month. As those measures clearly aimed at strengthening the monopolistic power of the state grain agencies in the market, no matter for what reasons, the market-oriented reform was held back or postponed

In May 1998 the State Council emphasised that the key points of the proposed reform in the grain marketing system were:

1. to procure surplus grain from farmers at the protected price without any quantity limit;
2. to re-sell grain at a price sufficient to cover procurement and marketing costs, or even provide some profit if possible;
3. to ensure the quantity of procurement fund, and its circulation in a closed cycle without any misappropriation; and
4. to push the reform of the state-owned grain enterprises further.

The details of the new policy was documented by the “*Liangshi Shougou Tiaoli* (Grain Procurement Ordinance)”, passed by the State Council on June 1, 1998 and put in effect on June 6. The Ordinance was applicable to the procurement of wheat, corn, rice, and other types of grain specified by the State Council or provincial governments. It explicitly prohibited anyone other than the state procurement agencies to buy grain directly from farmers including country fairs, with the only exception that the state-own agricultural enterprises were allowed to buy grain from their subsidiaries. In principle, the price for the “contracted” delivery should be set in line with the prevailing market price or the protected price, whichever was higher. The surplus provided by farmers, i.e., the above-quota delivery, should be paid at market price, or at the protective price if market price was below that level. The Ordinance also explicitly prohibited the re-sale of procured grain at deficit, meaning the retail price at least must be high enough to cover the full procurement and

marketing costs.

## **4.2 The Core of the New Policy**

There were two major stated objectives of the new policy: 1) to protect farmers from the prolonged low price; and 2) to reduce and eliminate government budget burdens in supporting the state grain marketing system. Those policy objectives were not new, as the policy makers had been struggling between the two for quite a long time during the reform. What was “new” was that monopoly had been selected as the measure to achieve the two goals at the same time, though it was certainly in contradiction with the general reform mood.

The logic of the new policy was as follows:

1. By eliminating all other buyers in procuring grain directly from farmers, the state agencies would be able to control the marketable grain completely;
2. As the sole supplier, the state agencies might be able to set prices at wholesale and retail markets at the level sufficient to cover the full costs, and probably obtain some profit; and
3. Being in such a position, the state grain agencies would be able to provide farmers with the “protective” price set by the government without burdening the government budget.

There were at least three important issues to be addressed. Firstly, if the efforts to achieve complete monopoly could succeed? Secondly, if the grain agencies would be able to set retail price at desired level? Thirdly, who should pay the costs that had been borne previously by the budget?

Stipulated by the new policy, the state grain agencies were mandated to procure all grain, no matter within or above quota, at a protective price higher than that prevailed in the market. Suppose the market price was at equilibrium, at which the market would be cleaned. Now, the state grain agencies had to procure at a price higher than that, add marketing costs and any possible mark-ups, and re-sell the grain at a price covering such full costs. Then, the demand would decline as price went up, how could

the grain agencies sell all the grain procured? If not, who would be responsible to cover the costs for extended storage and finally the losses due to the unsold grain? This question was never addressed, even were not raised for open discussion.

The implied welfare effect of the new policy was also never mentioned. As a matter of fact, if the government determined not to support the protective price with budget appropriation, then, consumers had to pay for that. It was quite understandable that open discussion of such issue would be politically undesirable. However, at least the feasibility of such measure should be examined more carefully. As stipulated by the new policy, the retail price charged by the grain agencies had to be high enough not only to cover the full costs for current operation, but also to pay back the deficit accumulated since 1992 in 5 to 10 years. If the 214 billion yuans had to be collected through such mark-ups in 10 years, then, each urban resident has to pay more than 70 yuans each year, implying about 0.7 yuans increase in grain price in addition to any inevitable increase resulted from the full-costs marketing. It seemed quite likely that the retail price for grain had to be doubled in order to achieve such a policy goal. In addition to the welfare issues, one question related to the above issue was, with such significant increase in price, how much grain would be kept in store?

Great efforts were made in strengthening the monopolistic power of the state grain marketing agencies. It was quite unusual that there were 10 out of the total 23 articles in the Grain Procurement Ordinance stipulating punishments on violations, and several applicable articles of the Criminal Codes were attached with the Ordinance when it was released. In addition, special measures were announced about two months later, explicitly aimed at punishing all possible activities violating the Grain Procurement Ordinance.<sup>10</sup>

It seemed that the government was mainly concerned with whether complete monopoly could be realised in the grain market. It might be true that the government believed that the market power would enable the state-owned grain enterprises pursuing and achieving the stipulated policy goals. Or, as Xiwen Chen reasoned, the new policy might be mainly aimed at getting rid of the accumulated deficit, hence was

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<sup>10</sup> “Liangshi Gouxiao Weifa Xingwei Chufa Banfa (Measures to Penalize Illegal Activities in Grain Purchasing and Marketing)”, the State Council, August 5, 1998.

a temporary measure and would be replaced with further market-oriented measures once the deficit had been covered (Chen, 1998).

### **4.3 Implementation of the New Policy**

Whether the retail price could be raised to a sufficiently high level was obviously a key to the success of the new policy, as definitely no further deficit was permitted. If consumers were able to buy grain from free market at a price below that level, the state grain agencies would face an extremely difficult situation. They had to procure grain from farmers at the high “protective” price, yet were unable to sell any thing without incurring deficit. Therefore, even they might be able to avoid current deficit in their accounting book by withholding procured grain, the storage, interests and labour costs were increasing with time while the value of the grain was decreasing due to physical losses and quality deterioration. As a matter of fact, the deficit was defaulted and possibly increasing at an accelerated rate.

The private traders were blamed for the market price being kept low, and it was hoped that the situation would change after several months when the state monopoly finally controlled the source of grain supply to those private traders. All policy and administrative measures related to grain marketing were diverted to strengthening the monopoly. However, despite continuing efforts made by the government, the market price was still at about the same low level, and had no signal of increasing during the rest of 1998, as well as in 1999 and 2000.

One apparent reason for the failure in pushing up grain price was the existence of the free market: the country fairs in the rural areas and the open market in the urban areas. After about 30 years of reform, it was impossible to close the free market, and it was also impossible to prohibit farmers to sell their surplus grain in the market, especially when one of the objective of the new policy was stipulated for protecting farmers. Therefore, consumers had no difficult to get grain supply from the free market at relatively low price, hence did not have to rely on the state grain stores at the full-cost price.

Fearing the accumulation of defaulted deficit, many state grain agencies started to

down-grade grain delivered by farmers in order to pay a price below the officially set “protected” one, or simply refused to accept the delivery. Of course the latter would meet with high political pressures. Some local governments stepped in to help the grain agencies (and partly to help themselves to avoid future budget burdens) by cutting the quotas set for the “contracted purchasing”. Although stipulated by the new policy quota and above quota deliveries should be paid at the same “protective” price and the procurement should be open-ended, the farmers’ complain for refusal of above quota delivery was relatively weak and hence the political pressures would be much lower. It was reported that at least 10 provinces reduced contracted purchasing quotas in 1998, some of the reduction was as high as 24 percent of the total. More provinces reduced their procurement quotas in 1999 to greater extent, for example, the quota in Jiangsu Province was cut by 44 percent in 1999.<sup>11</sup> Even the central government itself tried to cut the procurement of some types of grain that proved difficult to re-sell later. It announced that, in some regions, spring wheat, red wheat, early *Indica* rice, and corn, were not subject to protective prices any more after 1999. Altogether this meant that the budget burden did centre the new grain policy, and that the grain supply in the free market was never to be cut off, as the state agencies were simply unable to implement the policy of open-ended procurement at protective price.

The failure in pushing up grain price was basically due to the conflicts among stipulated policy objectives under current supply-demand conditions. If farmers, and implicitly future grain production and supply, should be protected by price higher than the equilibrium level at the market, how could the state agencies to procure grain open-ended at such a price and re-sell all at full-cost price? Or even at a higher price in order to pay back previous deficit with current profit? With complete monopoly, those agencies might be able to set retail price at any desired level. However, then they had to cut the quantity of their supply to a corresponding level. Who should cover the full costs for the over-procured and over-stored grain? In this regard, the grain agencies’ actions, such as down-grading and refusing buying, were rational in business consideration, though violating the self-conflicting policy.

In reality the state agencies did not have the power of complete monopoly, at least

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<sup>11</sup> Xinhua Ribao (Xinhua Daily), May 4, 1999, B4.

farmers might be able to compete with them in the market. Burdened with over-staff and all other common shortcomings of state-owned enterprises in general, as well as the existing accumulated deficit in particular, those agencies could not sell grain at the same retail price as farmers did in free market without incurring deficit, even when all of them had purchased grain at exactly the same price.

Therefore, the state agencies purchased a large quantity of grain, but could sell only a small percentage of it in the past three years. The stock in their hands increased as a result, along with defaulted deficit. Farmers did not benefit from the policy either, actually the price they received was much lower than that set by the policy as the “protective” one. Lack of competition in purchasing side, and due to the “rational” behaviour of the state agencies, farm-gate price was kept low, in turn, it helped to keep the retail price low in the market, re-enforcing the awkward situation faced by the state grain agencies and the policy makers.

## 5 Recent Changes in Grain Marketing Policies

The low prices for almost all farm products in the past 5 years have been taken as a clear indication that food security will not be a problem in the foreseeable future. The “strategic adjustment ” of the agricultural and rural sectors has been called for as a measure to increase farmers’ income against low market prices and to improve efficiency in resource allocation. Under such policy environment, the state grain marketing system, which was designed under totally different situations, seems to be unnecessary and even burdensome to a large extent, and some bold reform measures have been taken or announced recently. In addition, the existence and operation of the state grain marketing system is likely to be challenged during the negotiation of China’s accession into the WTO, as well as after the accession. After weighing the benefit and cost of maintaining the system itself, as well as the overall benefit and cost regarding all sectors, China may be willing to change the state grain marketing system significantly, or even abolish it in the future.

### 5.1 Changes of Grain Policies Since 2000

The long-lasting low market price, first for grain and then for almost all farm products since 1997, finally made the government believe that structure of agriculture had to make a big adjustment, and reducing grain sown areas was the most important component of the adjustment. Although the withdraw of a list of grain from the protective prices in 1999 could be taken as a signal of discouraging grain production, it was at the beginning of 2000 that the central government formally announced its plan to push “strategic adjustment in the agricultural and rural economic structures”.

According to Vice Premier Wen,<sup>12</sup> the current key points were: 1) to improve quality of all farm products in all aspects; 2) to speed up the development of the animal husbandry sector; 3) to develop processing sector for farm products; 4) to optimise regional structure of the agricultural sector; and 5) to adjust the employment structure of rural labour force. It was quite clear that the main objectives set for the agricultural sector had been formally changed, from stressing quantity to quality, from grain to non-grain crops, from crop to animal products. This change reflected that the government was quite confident that food supply was secured for the foreseeable time period, and that food security in the future would depend on keeping the capacity of production, as well as on maintaining farmers’ incentive to produce grain and other food products. Therefore, keeping arable land continuously used in agriculture and keeping farm product price and farm income at certain levels would be a crucial issue to be addressed. As non-grain production was generally more profitable than grain production, the “strategic structural adjustment” was viewed as the most important and most feasible measures to achieve such goals, as budget subsidy was ruled out from the very beginning.

It was reported in the spring of 2001 that grain marketing would be completely free in several provinces,<sup>13</sup> delivery quotas and protected prices would no longer exist, and the state grain agencies would be turned into true business enterprises in these provinces. It was reported, in some cases, even the grain administration bodies were abolished. It was believed, with grain supply being secured, the existence of the state grain marketing system might be unnecessary, and it would be quite safe to abolish

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<sup>12</sup> Wen, Jiabao. “Dangqin Nongye He Nongcun Gongzuo De Zhuyao Renwu (Major Tasks in Recent Agricultural and Rural Work)”, a speech at the Central Meeting on Rural Work, January 5, 2000.

<sup>13</sup> Shanghai, Zhejiang, Fujian, and a part of Jiangsu would free grain marketing first, Guangdong and Hainan may follow soon.

the system in those grain-importing provinces first. It was also hoped, after further reduction in grain production in those relatively rich provinces, their demand for grain imported from other major producing provinces would increase. As a result, the price and income would increase in the relatively poor grain-producing provinces.

Repeatedly stressed by the government and understood by most observers, the primary objective of the state grain marketing system is to ensure food security. As domestic food supply seems to have been in surplus for quite a long time, whether the system is and will still be necessary is once again questionable given the inefficiencies revealed in the past. The other major objectives set for the system, such as diverting agricultural surplus and supporting farm price and income, have proved either unrealistic under current situations or unachievable without huge budgetary subsidies. On the contrary, it has been acknowledged that abolishing the grain marketing system may actually increase farm price and income, as indicated by recent changes. Therefore, the conflict of objectives has suggested that the system needs more systematic and fundamental reform.

## **5.2 Potential Impact of the Accession into WTO**

The state grain marketing system will soon face another pressure calling for reform: the accession into the WTO. As many researchers have pointed out, China has lost its comparative advantage in many production of farm products, especially in grain and some other land-intensive crops. Under current prices and foreign exchange rate, imported corn, wheat, soybeans may have price advantages, as well as quality advantages, over domestic produce and hence are likely to bring heavy pressure on domestic production, and on the marketing system as well.

During the phased-in time period of about 4 or 5 years upon the accession, the quantity of such imports will be restricted by the Tariff-Rate-Quota (TRQ) system, with the total amount roughly equal to 3-4 percent of domestic consumption. Although such a percentage seems not very large, its impact may quite significant given the surplus in domestic market that has been lasted for about 5 years already. As the rationale of maintaining state grain system has been questioned facing surplus in the market, the additional supply from imported grain may add pressures to call for

reforming, and even to abolishing, the system. Such pressures may grow with time, as a more liberalised world trade scheme is likely to be established by the new round of multilateral trade negotiations.

More direct pressures to reform the state grain system may come from the conflict between China's domestic policy and the WTO rules and the agreements reached with major trading partners. Obviously our major partners will request termination of the procurement at "protective" price, as well as the state monopolistic marketing itself. They are likely to request termination of the state trading in grain also, which has been used in conjunction with the grain marketing system to serve a set of common policies. China may or may not make full compromise, depending how the top leaders weigh the potential benefits and losses among all sectors, and among economic, social, and political considerations. Nevertheless, some degree of compromise in changing the grain marketing system may be inevitable, and might be to China's advantage as the reform of the system has been long over-due.

## 6 Conclusion and Future Perspectives in Grain System Reform

The state grain marketing system was established in the early 1950s under quite tightened supply conditions. Its primary objective was to ensure food security in terms of adequate total supply, continued growth in domestic production, and efficient distribution among consumers and other end users. In addition to this basic policy objective, the system was used to divert agricultural surplus into industrial investment from 1950s to 1980s, in order to speed up industrialisation in the country. Later on, it was also used to increase farmers' income through procurement price subsidies to some extent. No matter how seriously the system has been criticised for years, it might served its policy objectives relatively efficient in its early years.

However, under the changed environment, it is time now to thoroughly reform the system. As the "strategic" structural adjustment in the agricultural and rural sectors has been called for by the central government, food security seems no longer to be a focus of the policy in foreseeable future. Then, old measure to achieve the old policy goal seems to be, or soon to be, out-of-date. Moreover, based on experience during

the last 20 years, many observers have argued that the market scheme might be more efficient to stimulate growth in grain production, and hence to ensure food security. Following decades of rapid growth in the urban-industry sector and the declining of agriculture's share in the national economy, the role of the grain marketing system in diverting agricultural surplus has diminished. In fact, it has turned to be burdensome to the government budget for years. On the other hand, the government has clearly shown its intention not to support grain price anymore, and has actually acknowledged that the price might be improved by freeing the grain market.

If the above factors are likely to be internal incentives to reform the state grain system, the accession into the WTO may bring external pressures to do it. If China is not willing to make more compromises in other sectors, such as IT, finance, insurance, and etc., it must agree to reform her domestic agricultural policies, including the state grain marketing system.

There are still some possible concerns regarding the continuing existence of the grain marketing system. Firstly, food security is still concerned by many policy makers and researchers. To some of them, administrative measures, such as the grain marketing system, are familiar, powerful, and convenient policy tools. Secondly, the accumulated huge deficit is likely to be a problem for the top leaders. How to treat the deficit, if the system is to be turned into commercial enterprises, may become a political issue among the policy makers. Nevertheless, freeing the market will discontinue any further accumulation of the deficit, this has been acknowledged by the government. Continuing the operation of the system will just do the opposite.

It seems that the pace of further reform of the state grain system will mainly depend on grain demand-supply conditions in the decade to come. Relaxed supply may encourage the government take bolder measures to push the market-oriented reform, while the tightened supply may lead to some degree of setback in the reform. If food supply is secured, and the market signals are proved more efficient in resource allocation and income generation, the market-oriented reform is likely to continue, with the state grain enterprises finally transformed into real commercial business.

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The grain procurement and marketing system was established in China in the early 1950s. The primary policy objective was to ensure equal and relatively efficient distribution of limited grain among consumers and industrial users, and to ensure the growth of grain production at the planned rate. At the same time, it was assigned. Discover the world's research. Five characteristics mark China's economic and political system as unique: China has always considered agriculture a fundamental sector in its economy. Over the past three decades, the growth of agriculture has been the foundation for the successful transformation of China's economy. China has developed an effective and competitive market system, with its agricultural markets integrated not only domestically, but also with international markets. The Communist Party of China (CPC) is the country's sole political party in power. Domestic interventions began with releases of government grain stocks to increase the supply of grain in the domestic market. Today, China has a central role in the global political economy. Its role as a manufacturing base is clear. One of the most interesting cases of Chinese investment in the west is the purchase of the 200 year old ThyssenKrupp in Dortmund Germany which had once employed around 10.000 people. The plant had to close as a result of increased competition from Mills in south Korea and other Asian countries as well as the 2000 slump in global steel prices. Within a month of the plant being put on the market, a Chinese steel company called "shagang" had bought it. The company then proceeded to dismantle it piece by piece and ship it back to China. The economy of the People's Republic of China is a market-oriented economy that incorporates economic planning through industrial policies and strategic five-year plans. Dominated by state-owned enterprises (SOEs) and mixed-ownership enterprises, the economy also consists of a large domestic private sector and openness to foreign businesses in a system described as a socialist market economy. Since the 12th National Congress of the Chinese Communist Party in 1982, the economy has been described as a...