



International Trade Report

March 26, 2004

China Grain Situation and Outlook

Summary

The Chinese government's latest efforts to boost grain production are different from the mid-1990s, when the state had more control over production and trade. In contrast, the recent official measures are modest, reflecting a changed political climate, limitations of political infrastructure, and natural resource constraints. It is therefore unlikely that the new measures will reverse the trend of consumption outpacing production. As long as China's total grain supplies appear to be tight, the United States will benefit in both wheat exports to China and corn exports to Asian markets.

Current Situation

In mid-February, the Ministry of Agriculture (MOA) announced numerous measures to promote grain production. Among them are direct subsidies to grain farmers, lower agriculture taxes, and financial support to farmers who use high quality seeds or who purchase machinery.

These measures recall memories of the mid-1990s, when inflation and perceived shortfalls in stocks led the government to reverse its previous market liberalization measures and introduce the "Governor's Grain Bag" policy designed to promote regional self-sufficiency. Back in 1994, the government responded to soaring prices by halting exports and allowing large imports of wheat and corn. This year has seen a similar short-term reaction, albeit on a smaller scale.

However, in terms of policy direction, several factors preclude Beijing's reverting to the mid-1990s mode of thinking: First, the "Governor's Grain Bag" policy was dismantled because it did not allow provinces to pursue their comparative advantages. Second, water constraints and competition in land use limit expansion of grain areas. Third, the government has been reducing its role in grain markets and reversion to a "Grain Bag"-style program would be a drastic policy reversal. Overall, the policy of the past five years has been directed toward market liberalization and more reliance on price signals to influence production decisions, with an emphasis on the rationalization of production (letting each region grow crops utilizing its comparative advantages). To wit, Beijing has left the decision as to how the new production support should be distributed to individual provinces. In addition, the government is calling for an open procurement and marketing system, while shifting financial support away from the distribution channel and more directly towards farmers.

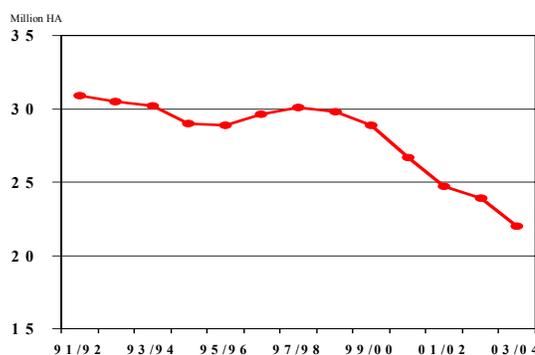
After years of reform, the government lacks the policy tools, e.g., procurement quotas, to compel farmers to plant specified crops. Despite all the official announcements promoting grain production, farmers appear to base their planting decisions on prices and profits rather than government directives. A late-February MOA spring planting intentions survey seems to confirm this. It shows wheat and corn losing out to other crops, mainly soybeans and cotton, both of which currently have very attractive prices for Chinese farmers.

Wheat Situation

Production

China is the world's largest consumer of wheat and the second largest producer (after the EU). It had also been one of the world's key importers, but in the late 1990s, a string of record harvests allowed China to attain self-sufficiency and begin amassing huge stocks. During the past four years, however, production has fallen substantially – primarily because farmers have been switching from grain cultivation to oilseeds, cotton, and other cash crops for higher returns. As production dropped below consumption, wheat stocks began to shrink. In 2003, the government reversed its previous policy and began promoting grain production again. However, reports from China are that winter wheat area will fall again in 04/05, with plantings down 2-3 percent from last year.

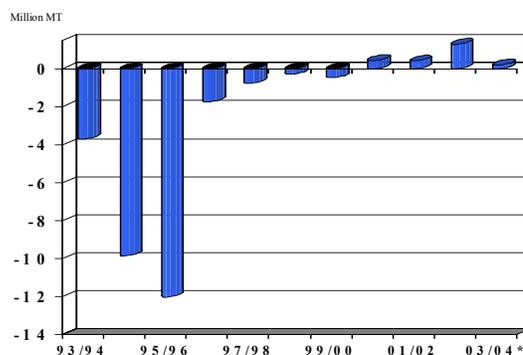
Wheat Harvested Area



Trade

As the country modernized and wheat consumption soared through the 1980s and early 1990s, imports reached as high as 15 million tons a year – mostly from the United States, Canada, and Australia. During the latter half of the decade, however, the large harvests curtailed imports and in 2000, for the first time, China became a net exporter of wheat. Due to shrinking stocks, however, this status is unsustainable, and if the declining production trend continues, China is likely to import large volumes to satisfy domestic demand. The tightening situation has been demonstrated in rising domestic prices this past year. China has recently resumed purchasing large quantities of wheat with nearly 3 million tons from the United States and also large purchases reported from Canada and Australia. While Chinese feed-quality wheat exports had been strong during the first half of this trade year, the second half should see a steep drop-off in volume, which could benefit U.S. corn into markets such as South Korea.

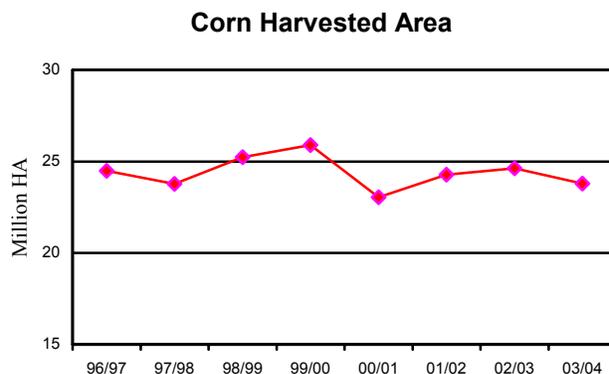
China's Net Wheat Trade



Corn Situation

Production

The Northeast region (Heilongjiang, Jilin, Liaoning, and Inner Mongolia) produces one third of China's corn crop and over two-thirds of its exports. Cash crops are limited in this region due to the colder weather. The chief competing crop to corn is soybeans. In recent years corn area has lost not only to soybeans but also to environmental protection measures. Soybeans could see another boost in acreage at the expense of corn in the Northeast after last year's soaring prices. The recent planting intentions survey indicates that overall soybean acreage will increase 13.5 percent from last year, much of which would be in the Northeast, while corn will decline 2.4 percent.



Since there is not much additional land to expand corn production, the focus is on raising yields through better seed use, improving cultivation methods, and protecting existing cropland from industrial uses and urbanization.

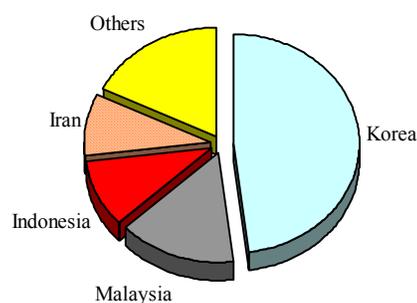
Trade

The year 1994/95 was a turning point in China's agriculture policy. Between the mid-1980s and mid-1990s, China had been a net corn exporter. In 1994/95, China abruptly halted exports and began importing large quantities from the United States, totaling over 4 million tons that year. Part of the reason for this abrupt reversal can be attributed to a smaller crop and warehouse mismanagement that led to a perceived reserve shortage. In 1995 then-Premier Zhu Rongji introduced the so-called "Governor's Grain Bag" policy that aimed for each province to reach self-sufficiency. Grain production soared in the late 1990s, causing huge stock build-ups.

To relieve the pressure posed by bulging stocks, China began aggressively subsidizing corn exports through Value Added Tax rebates and warehouse subsidies that helped move grain out of reserves. In addition to central government subsidies, provinces such as Jilin, which has traditionally been a surplus producer, also provided export support.

The Northeast's proximity to South Korea helped China access one of the world's largest

2002/03 Importers of Chinese Corn



corn import markets (9 million tons). China became the primary corn supplier to South Korea at the expense of the United States. Other major markets have included Malaysia and Indonesia. In 2002/03, China's corn exports expanded far afield, reaching destinations in Africa and the Middle East. Total exports that year reached a record 15.2 million tons.

Outlook For Trade

This year, China will most likely lose those peripheral markets and will only export to traditional Asian markets as supplies tighten. After suspending new export contracts for two months, the government recently announced a 1.4 million ton export quota for the first half of 2004, compared to last year's exports of 6.7 million tons during the same period. Aggressive exports may be a thing of the past, now that China's stocks appear to have dropped to a reasonable level and consumption continues to outpace production. In the long run, China will likely maintain small exports to South Korea and nearby destinations, given its freight advantage, but more corn has to stay home to meet expanding domestic demand fueled by growth in feed and industrial use. Though corn imports appear unlikely this year given record freight rates, a less-than-stellar fall harvest and ensuing high prices could make imports possible next year.

Implications For U.S. Exports

For wheat, China has become the bright spot in Asia for the United States as exports to the rest of Asia continue to decline. For 2004/05, China should be a very important market for U.S. wheat, having already purchased large quantities. Reduced Chinese corn exports are providing opportunities for the United States to regain markets in Asia, as South Korea, Malaysia, and Indonesia seek non-Chinese supplies. Already U.S. sales to these destinations have far exceeded previous years' levels. Although curtailed Chinese exports have also allowed nontraditional exporters such as Thailand and India to expand their share in the region, these exporters can only supply a small percentage of the area's needs. Hence the United States should still have a dominating presence.

For more information, contact Hui Jiang (202-720-2231) and Levin Flake (202-720-4258) or Hui.Jiang@usda.gov & Levin.Flake@usda.gov