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China's Agriculture Policy and U.S. Access to China's Market

China's rising living standards and the transformation of its economy pose a major opportunity and challenge for the global food system in the 21st century. The United States—with abundant land and water and a history of agricultural innovation and efficiency—is well-positioned to be a major supplier of food and fiber to China's urbanizing and increasingly affluent consumers. China is now the largest export market for U.S. farm products. U.S. agricultural exports to China reached nearly \$26 billion in calendar year 2012, up from \$13 billion in 2009. However, there is potential for conflict that could undermine this important trading relationship.

Most of China's rising demand for food and fiber has been supplied by its own farmers. During the first three decades after introducing market-oriented reforms, China's agricultural output grew and diversified in a remarkable manner. According to Food and Agriculture Organization estimates, China's per capita calorie supply was 13 percent below the world average in 1980 and rose to 7 percent *above* the world average in 2009 (fig. 1). The per capita supply of animal-based protein increased even more dramatically, rising from about one-third of the world average in 1980 to 19 percent *above* the world average in 2009 (fig. 2). China is now the world's leading producer of a wide range of commodities. The country's share of world production of many major commodities equals or exceeds its 20-percent share of world population (table 1).

Despite its success over the past three decades, China's small-farm-production and collective-land-ownership model is facing mounting challenges as the country's demand for commodities outstrips supply, costs and prices escalate, and imports surge. Large numbers of rural people in China are withdrawing from agriculture as off-farm opportunities improve. Authorities now worry about "hollow villages" and "atrophy of agriculture" as part-time farming becomes prevalent, some land is left uncultivated, and investment in agriculture lags. As the country urbanizes, new problems have arisen related to food safety, pollution from animal waste and chemical fertilizer, and disease threats. These problems reflect pressures from intensive use of land and water, dense livestock populations, and fragmented production and marketing. In order to achieve agricultural sustainability in a new era of urbanization and industrialization, China will need to increase its reliance on agricultural imports to ease pressure on its limited resource base. However, there is still considerable pressure to protect farmers from import competition in order to increase rural incomes.

China's WTO accession in 2001 lowered barriers to agricultural trade, and both imports and exports surged in the ensuing decade. While there are a number of specific concerns that will likely be raised in other testimony at this hearing, broadly speaking, China has been responsive to WTO requirements in reforms of trade policies, increasing transparency, and crafting a domestic support policy that conforms to WTO rules. Policies and practices are shaped by WTO rules and generally meet the "letter of the law," if not always its spirit.

Since joining WTO, China has increased its domestic support for agriculture rapidly. Chinese officials say increased budgetary support and higher prices for the agricultural sector is an inherent part of the transition to an urbanized and industrialized economy. Chinese officials say their strategy is to give the maximum amount of support allowed by WTO rules. Most expenditure is focused on so-called "green box" programs that are not limited by WTO, and the expenditure is largely devoted to infrastructure and other supporting programs to increasing grain production capacity. Most direct payments to farmers are only loosely tied to "grain" production (but not to specific commodities) so they can be declared as either "green box" or "non-product-specific" measures so they do not count toward commodity-specific *de minimis* limits. The value of "market price support" reported to WTO is kept modest by declaring only the volume of commodities actually purchased under the program as "eligible" for support.

For one commodity—cotton—China appears to have exceeded its WTO *de minimis* limit by purchasing large volumes of cotton at support prices during 2011/12 and 2012/13. The cotton support price policy appears motivated to maintain domestic production of cotton, but it actually promotes imports of cotton in the short run. Most of this year's Chinese cotton crop was placed in reserves while China's cotton imports continued at a robust pace.

The competitiveness of Chinese agricultural commodities vis-à-vis imports is eroding as farm production costs escalate, its currency appreciates, and agricultural productivity grows slowly. Agricultural imports have been rising, prompting concerns in China about "food security." In 2012, China imported over 80 percent of the soybeans it consumed. According to Chinese officials, imports of corn and wheat rose to 4 percent and rice to 2 percent of consumption last year. China's traditional measure of self-sufficiency in "grain" (including cereals, soybeans, and potatoes) fell below 90 percent during 2012.¹

China's food security and related "industry security" concerns are a primary driver of its agricultural policies. These concepts are nuanced and difficult for outsiders to understand. Chinese government and industry officials assert that the volume of potential Chinese demand is so large that the country's imports would outstrip the capability of world markets to supply the country. They also express strategic concerns that reliance on imports of any particular commodity will leave the country vulnerable to global price fluctuations and manipulation of prices by other countries or multinational companies.

¹ "Wo Guo Liangshi Zigei Lü Die Po 90% [Our Country's Grain Self-Sufficiency Rate Fell Below 90%]," China Broadcast Network, January 30, 2013.

Domestic agricultural policy reflects food security concerns. China's price supports and subsidies are focused on preventing declines in production of staple food grains—rice and wheat. The “industry security” concern is reflected by authorities' hesitancy to reduce the support price for cotton during the last two years. They have expressed concern that cotton production might plunge if the cotton price falls, increasing reliance on cotton imports. Another example is a set of initiatives to boost domestic production and processing of vegetable oils from rapeseed and peanuts to offset the reliance on imported soybeans.

Wary of relying on a single country as a supplier, Chinese authorities also have a strategy of diversifying agricultural trade partners. This strategy is likely behind Chinese initiatives to develop Argentina and Ukraine as potential suppliers of corn imports during 2012.

The self-sufficiency ideal is becoming harder to attain as China's consumption expands and domestic production encounters resource constraints. Over the past decade, reliance on agricultural imports was compartmentalized by importing certain commodities like soybeans and cotton while remaining self-sufficient in key commodities like rice, wheat and corn.

Chinese officials now often espouse a “two markets, two resources” strategy for supplementing domestic commodities with imports. The strategy is not explicitly spelled out but appears to call for control of overseas farm production, processing and logistics by Chinese companies for commodities that cannot be supplied domestically. Chinese officials advocating this strategy assert that vertical integration gives multinational grain companies a cost- and price-advantage in global markets, and they say Chinese companies need to imitate this strategy by controlling their supply chain.

Many Chinese companies and local governments have ambitions to invest overseas. The National Development and Reform Commission formulated a strategic plan for overseas agricultural investment. The two flagship companies chosen to shore up vegetable oil supplies are Chongqing Grain Group and Beidahuang (an agribusiness company created by the Heilongjiang Province state farm system) which have plans to invest in soybean and rapeseed production, processing and logistics in Brazil, Russia and Canada. Reportedly, Chongqing Grain Group has already begun importing soybeans from its Brazil project. COFCO and other state-owned companies are engaged in overseas investment in soybean, cassava, wine, rubber, and sugar projects. The strategy is financed by earmarked loans from State banks and facilitating public offerings in China and overseas equity markets.

China and the United States are natural trading partners in agricultural products. We are now at a key juncture in this relationship where China is transitioning from its historical character as a nation of villages and farmers to an urban-industrial society. As China becomes a nation of urban consumers there will be greater impetus to import agricultural products. Both countries can gain by establishing a stable, mutually-beneficial relationship in agricultural trade, but the two countries have differing priorities and policy approaches with potential for conflict. In coming

years it will be important to understand these differences in order to prevent mounting conflicts over small matters that may undermine the broader trading partnership forming between China and the United States.

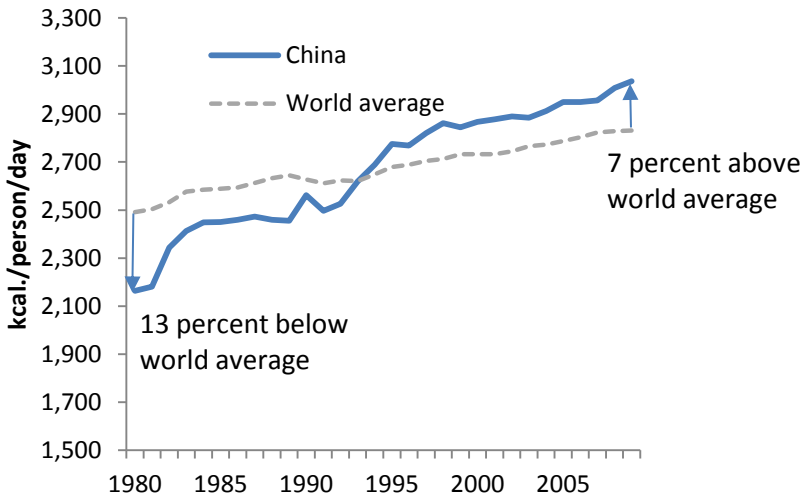
Table 1. Shares of world production, population and land, China and United States, 2012

Item	China	United States
Production shares for major commodities	Percent	Percent
Soybeans	5	31
Fluid milk	6	17
Sugar	7	4
Beef	10	20
Broiler chickens	17	20
Wheat	18	9
Corn	24	32
Cotton	29	14
Rice	31	1
Pork	49	10
Apples	56	6
Total population*	20	4
Agricultural population*	31	< 1
Cropland*	8	10
Grasslands*	12	7

*U.N. Food and Agriculture Organization, FAOSTAT, 2011.

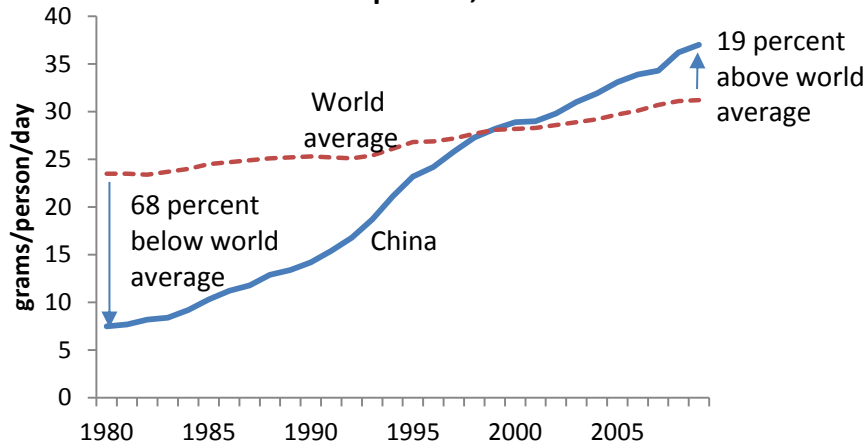
Source: Calculated by ERS from USDA Production, Supply and Distribution estimates, except where noted

Figure 1. Per capita food supply, China and World average, 1980-2009



Source: ERS analysis of data from U.N. Food and Agriculture Organization, FAOStat.

Figure 2. Per capita supply of animal protein, 1980-2009



Source: ERS analysis of data from U.N. Food and Agriculture Organization, FAOStat.