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## **China - Peoples Republic of**

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### **Chinese Government Tackles High Production Costs and Uncompetitive Prices in New Agriculture Strategy**

**Report Categories:**

Agricultural Situation

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**Report Highlights:**

On February 1, 2015, China issued a major policy document on agriculture calling for a coordinated response to rising production costs and internationally uncompetitive prices. The plan calls for subsidy and land reform, in addition to exploring greater utilization of innovative agricultural technologies such as biotechnology. While the document is short on specifics, the 2015 No. 1 Document emphasizes the need to make Chinese agriculture more competitive, efficient, and sustainable.

**Executive Summary:**

On February 1, 2015, China issued a major policy document on agriculture calling for a coordinated response to rising production costs and internationally uncompetitive prices. Policy makers have become alarmed by the widening gap between domestic and international prices. The plan calls for subsidy and land reform, in addition to exploring greater utilization of innovative agricultural technologies such as biotechnology. While the document is short on specifics, it openly acknowledges the need to adopt policies that will make Chinese agriculture more competitive, efficient, and sustainable.

The fact that Chinese authorities seem to have recognized, and are taking steps to tackle their market- and trade-distorting policies, seems a positive sign – for the agricultural sectors of China and of the world. The implementation of these reforms over the next five to ten years, however, will likely entail some level of turbulence and uncertainty for agricultural exporters such as the United States.

**China's 2015 Number One Document:**

On February 1, 2015, the Chinese Communist Party issued a “No. 1 Document” outlining China’s new agricultural strategy. The No. 1 Document is so called because it is the first policy document issued by the Chinese Communist Party each year, and is reserved for important issues (usually agriculture). The document raised alarm over what it describes as the “double squeeze” of rising production costs and internationally uncompetitive prices. In response, the document calls for a concerted strategy to increase the competitiveness of China’s agricultural sector through subsidy and land reform, as well as greater utilization of innovative agricultural technologies.

Previous No. 1 Documents on agriculture primarily focused on increasing agricultural production and farm incomes and the government has steadily raised agricultural support prices since 2008 to achieve these goals. These supports and other factors have helped push production costs for most Chinese grain and livestock products well above world market prices. For example, domestic corn prices are now (March 2015) more than double international levels. This has led to increased import demand even when there are ample domestic supplies. China now holds over 40 percent of world corn stocks and over 50 percent of world cotton stocks. While the government is not expected to release these stocks on a large scale, doing so suddenly could destabilize global agricultural prices. In addition to creating competitive issues for downstream products such as meat, dairy, and textiles, it is widely recognized that these policies have resulted in large financial and environmental costs.

Below is a summary of developments in the 2015 No. 1 Document in the areas of food security, subsidies, biotechnology, land reform, water, and international trade. While the document is short on specifics, it does reflect an enhanced awareness of the need to make Chinese agriculture more competitive, efficient, and sustainable. An English transcript of the press conference discussing this strategy can be found on the [Ministry of Agriculture's website](#).

***Food security***

Ensuring food security remains the government’s top agricultural priority. However, how the government defines food security has evolved over time. Chinese leaders have gradually realized that the policy of equating food security with self-sufficiency is not sustainable in the long run and may be

counterproductive. Some policy makers have begun to point out that China's limited land and water resources will make it difficult to increase feed production enough to meet the growing demand for animal products from its burgeoning urban middle class.

This evolution in thinking is reflected in recent No. 1 Documents. The 2013 No. 1 Document focused on increasing production of major agricultural commodities by raising the floor prices for wheat and rice and implementing a temporary reserve system for corn, soybeans, rapeseeds, cotton and sugar. The 2014 No. 1 Document took an important step away from the previous rigid definition of food security as equaling 95 percent self-sufficiency, and instead called for "basic self-sufficiency" in grains and "absolute security" in staple grains. Officials explained that while China would try to maintain self-sufficiency in staple grains such as wheat and rice, increased grain imports for feed use were no longer seen as a threat to food security.

The 2015 No. 1 Document took another step back from binding targets, saying only that the self-sufficiency level for major grain varieties should be "scientifically defined." The government continues to see self-sufficiency in rice and wheat as essential to China's food security and it maintains the floor price system for these crops. At the same time, it recognizes the need for a more flexible policy to meet the rising demand for feed. This is unlikely to result in higher corn imports in the near future due to strong domestic production and excess stocks, but long term prospects for trade remain positive.

While Chinese officials have called for greater utilization of international markets to meet growing demand, they remain wary of reliance, or even the perception of reliance, on any one country. The No. 1 Documents in recent years have called for China to "optimize import sources" by diversifying suppliers, and have prioritized the creation of import monitoring systems for key commodities. The 2015 No. 1 Document continues these policies. Quarantine officials have reportedly made it a priority to complete import protocols with alternative suppliers of key products. While the United States remains the largest exporter of agricultural products to China, its market share has declined slightly in recent years.

### ***Domestic support policies***

China's domestic agricultural support has in recent years focused on maintaining high internal prices through government purchases in order to boost farmer income and encourage production. China's National Development and Reform Commission began raising support prices for key agricultural crops in 2008 when global agricultural prices were high, and continued to do so every year until 2014 despite falling international prices. This has created a widening gap between international and domestic prices and left the government with excess stocks in many commodities that it cannot sell without incurring large losses. These policies have also attracted imports even during times of record domestic production.

The 2014 No. 1 Document announced a trial subsidy reform in key production regions for cotton and soybeans. This change reflected the realization by Chinese policy makers that their "temporary reserve" stockpiling policy has distorted domestic markets. The 2015 No. 1 Document called for continuing current subsidies and price-support programs while evaluating the effectiveness of the trial program for cotton and soybeans. It also called for improvements to the temporary reserve system, which is

currently used for corn, rapeseed, and sugar. In addition, it proposes expanding use of Green Box agricultural subsidies and adjusting Amber Box measures to more directly benefit farmers. (Information on Green, Blue and Amber Box Subsidies is available on the [World Trade Organization website](#).)

Chinese policy makers and academics have begun to cite what they describe as the “two ceilings and a floor” that are putting what the 2015 No. 1 Document describes as a “double squeeze” on the income of farmers. The floor is the rising cost of agricultural production in China. With costs rising, officials fear farmers will switch to non-grain crops or let their land lie fallow if prices do not rise fast enough to maintain healthy returns. The first ceiling is the price at which imported grain becomes competitive even when subject to the 65 percent out of quota tariff. With Chinese prices already exceeding global prices, officials worry that raising domestic prices even higher will result in a flood of imports. (Large amounts of sugar and cotton were imported at out of quota rates in recent years.) Officials left all support prices unchanged in 2014, likely due to this concern. The second ceiling is the WTO limit on Amber Box subsidies that restricts them to 8.5 percent of value of production. Several high-ranking officials have recently stated that China has already reached this limit. This constraint limits policymakers’ ability to raise price supports higher or to give farmers direct subsidy payments that are coupled to production.

Many officials in China have suggested that the temporary reserve system will be gradually phased out and replaced with a target price system like the one being applied to soybeans and cotton on a trial basis. The experience from these trials will be evaluated to determine whether the target price system should be implemented more widely. China is also expanding agricultural insurance, intergovernmental transfer payments to support agricultural counties, and experimenting with a type of price-loss insurance for hogs and vegetables. It will also likely explore decoupled payments or other Green Box measures to support farm income given its limited space to increase Amber Box payments.

*See Annex 1 for a table of domestic support policies in China’s 2015 No. 1 Document.*

### ***Biotechnology:***

The 2015 No. 1 Document identifies innovation and advanced production methods, such as biotechnology, as essential to boosting China’s agricultural competitiveness. While previous No. 1 Documents have mentioned the importance of biotechnology research, the 2015 No. 1 Document for the first time called on the government to conduct public outreach and to “popularize biotechnology.” The government has identified low public acceptance as an obstacle to expanding commercialization of biotech crops and is now developing plans to actively address this issue. In September 2014, the government released remarks by President Xi Jinping saying that biotechnology has “bright prospects” and calling for China to “take the commanding heights in biotechnology.” Despite the government’s recognition of the importance of biotechnology for Chinese agriculture, the Document does not telegraph any change in its restrictive policies on development or approval of “foreign” biotech products. See our [2014 Agricultural Biotechnology Annual](#) GAIN report for additional information.

### ***Land Reform***

Chinese leaders have identified the fragmentation of agricultural land holdings as a key obstacle to improving agricultural competitiveness. The average farm size in China is only around 1.5 acres, compared to over 400 acres in the United States. Agricultural land-use rights in China are highly

complex and often unclear, making consolidation of fragmented holdings difficult. Prohibition on the purchase or sale of agricultural land further complicates the situation.

The 2013 No. 1 Document tried to tackle this challenge by calling for the registration of contractual (chengbao) agricultural land titles to be completed within five years. It also encouraged people holding title to contractual agricultural land to lease their land to larger operations. The 2014 and 2015 No. 1 Documents built on these goals, and identified increasing the scale of farms as essential to improving competitiveness. The government is currently working on reforming related laws and regulations to facilitate the renting and mortgaging of rights to use agricultural land. At the same time, officials are launching new campaigns to designate tracts of “permanent agricultural land” to prevent loss of cropland to nonagricultural development. Further reforms are likely in the next several years, although direct sales of agricultural land are not being considered.

### ***Water price reform***

China’s per capita renewable freshwater resources are only a third of the world average. This places a significant constraint on the agricultural sector, which already accounts for over 60 percent of water use in China. Water for agricultural use is currently heavily subsidized and typically charged by area rather than consumption. The water fee for irrigating an acre of wheat ranges from 77 U.S. cents a year in Hubei to \$5.18 in Anhui. The fixed rates encourage over exploitation of water resources and have led to dropping water tables in some regions.

The 2015 No. 1 Document proposes addressing this problem by implementing a consumption-based fee system. Water for agricultural use is expected to become more expensive, while subsidies will be given to non-agricultural users. The exact pricing and mechanics are yet to be decided. According to local media reports, a pilot program will soon begin in 80 counties across China with a focus on regions that currently over-extract ground water. Water price reform is seen as a necessary step for allowing water to be traded between different provinces and regions. The government is investing heavily in water diversion projects, including the massive South-North Water Diversion Project. The 2015 No. 1 Document also calls for adoption of water saving irrigation technologies.

### ***International trade and cooperation***

China’s No. 1 Documents focus mainly on domestic policies and rural affairs, but the last two have included sections on international trade and investment. This reflects a new food security strategy that calls for utilizing domestic and international markets to ensure stability and reliability of the country’s food supply, a strategy stated in 2014 and 2015 No. 1 Documents. The increased attention to trade also reflects a heightened concern about competitive pressure embodied in the “double squeeze” rhetoric.

China’s strategy aims to closely manage trade. The 2014 and 2015 No. 1 Documents both call for developing plans for regulating the flow of imports, and the 2015 No. 1 Document emphasizes tight management of the tariff rate quota systems. The Documents call for exerting greater control over the border through strict inspections and crackdowns on smuggling of agricultural products. Dual objectives for the border controls include maintaining quality of imports, as well as protecting domestic producers to maintain “industry security.” A number of officials have described a surge in rice smuggling as a threat to national food security. News media report that allowances for border residents

to import limited volumes of rice and other commodities have been abused, and the 2015 No. 1 Document calls for reform of this policy.

The 2014 and 2015 No. 1 Documents also call for supporting a greater role for Chinese companies in international agricultural trade through outbound investment. China’s so-called “going out” or “go global” strategy had received brief endorsements in 2007 and 2010 Documents. The most recent No. 1 Documents were more specific, calling for nurturing large international companies and exploring policies to support outbound investors. COFCO’s purchases in 2014 of Nidera as well as Noble Group’s agricultural unit are seen as part of this strategy. The 2015 No. 1 Document also emphasized international cooperation, which appears to encompass both Government-to-Government cooperation and outbound investment by companies.

*See Annex 2 for a table of international trade and cooperation policies in recent No. 1 Documents.*

*The Beijing Office of Agricultural Affairs thanks Fred Gale, Senior Economist at the U.S. Department of Agriculture Economic Research Service, for his assistance with this report.*

**Annex 1: Main Domestic Support Policies in China’s 2015 No. 1 Document**

Subsidies	Continue direct subsidies to grain farmers, subsidies for improved strains of seed and livestock, agricultural machinery and equipment purchase subsidies, and general input subsidies
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	Provide preferential machinery and equipment purchase subsidies for “new-type” farm operators and include irrigation equipment in subsidies
	Give aid for the dissemination of major agricultural production technologies
	Evaluate the experience from target price pilot programs for cotton in Xinjiang and soybeans in the northeast and Inner Mongolia
	Develop agricultural price insurance pilot programs
Intergovernmental transfer payments	Implement the financial award system for major grain and oilseed-producing counties, seed-producing counties, and hog, beef and sheep-producing counties
	Expand the scope of financial awards for modern agriculture demonstration districts
	Establish an intergovernmental compensation system for grain-producing areas, compensation for cropland protection, and an ecological compensation system
Market intervention and monitoring	Continue minimum price procurement for rice and wheat
	Improve the temporary reserve purchase policy for agricultural commodities
	“Rationally determine” the size of grain, cotton, sugar, and meat reserves
	Improve the national grain reserve market intervention mechanism, and strengthening oversight of grain reserves
	Implement a new plan for increasing local grain reserves
	Establish a system for commercial grain trading enterprises to hold reserves on the government’s behalf, and improve the sugar mill government reserve-holding system
	Use modern information technology to improve surveys of crop area and production, and improve monitoring of production costs and prices

## Annex 2: International Trade and Cooperation Policies in Recent No. 1 Documents

2014 No. 1 Document	2015 No. 1 Document
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More actively utilize international markets and resources to adjust and supplement domestic supplies of agricultural products	Increase the capacity to make coordinated dual use of domestic and international markets and resources
Strengthen import plans and guidance for agricultural products, improve the mix of import sources, and establish stable, reliable trading relations	Keep a good grip on import, export, and tariff rate quota management of grains, cotton, sugar and other major agricultural commodities. Strictly enforce the sliding scale tariff policy for cotton.
Closely coordinate departments to strengthen border inspections and quarantine	
Maintain import quality and domestic industry security	Actively support exports of competitive agricultural products
Strictly crack down on smuggling of agricultural products	Strictly crack down on smuggling of agricultural products; improve the policy for trade by residents of border regions.
Accelerate implementation of the agricultural “go global” strategy	
Nurture large internationally competitive grain, oils and cotton companies.	Speed up nurture of internationally competitive agricultural companies and conglomerates
Encourage financial organizations to actively innovate services, financial products and methods for agricultural international trade and “going out”	
Explore establishment of an international agricultural trade fund and an overseas agricultural development fund	Establish a foreign cooperation conference system, formulate plans for international cooperation, and strengthen cooperation in trade, processing, storage and transport
Strengthen international cooperation in agricultural science and technology	Support investment in foreign agricultural cooperation by improving finance and tax, banking, insurance, trade, inspection and quarantine policies