The Emergence of Private Rice Marketing In South China

A few years ago, the government-owned Grain Bureau had responsibility to purchase paddy rice from farmers, and transport, mill, and retail the milled rice to urban consumers. Now private entrepreneurs are undertaking many of the tasks performed by the Grain Bureaus. This article explains how private millers have been able to compete with the Grain Bureaus, producing a dramatic shift in the way rice is marketed in south China. [Xiao-peng Luo and Frederick W. Crook (202) 219-0002] [1]

In 1996, soon after China's Government announced the price increase for the compulsory grain quota, the market price dropped below the new government prices. For the first time in more than 4 decades, the rice directly marketed by the farmers dominated all urban markets in south China. With prices down and sales to the government up, government stocks increased and exceeded storage capacity. These large stocks incurred huge financial costs and loss of rice through mildew and insect damage.

The Number of Private Rice Traders Increased Rapidly

The rapid growth of farmers' capacity to market rice surprised many people. Recent trips to south China revealed that private firms are now capable of participating in all major rice markets in south China with unprecedented efficiency. Rice produced in the traditional surplus provinces such as Anhui, Jiangxi, Hubei, and Hunan were first being husked locally, then shipped in large quantities by thousands of trucks to the market areas, such as Shanghai, and cities in Zhejiang, Fujian, and Guangdong provinces. The railway transportation bottleneck is no longer a constraint because of the competition from truck transportation. In the current price structure, the economic range for shipping rice by truck 300 to 400 miles depend on price differentials in different markets. Other motorized land and water transportation modes, including motorized junks, were also competitively used in marketing rice in different distances. For example, the rice produced in Anhui province, along the Yangzi river, was shipped by boats to ports along the river and southeast coastline such as to Fuzhou and Shantou, therefore competing with the rice produced in Jiangxi province transferred through railway and highway.

Since truck transportation can respond to market changes through overnight delivery, the price gap between any two rice markets were almost constantly within the range of transportation costs. Sometimes the intense competition actually drove the price gap between two trading areas to less than the transportation cost. In late December 1996, this was the case in Guangzhou (Canton) and Nanchang, the capital city of Jiangxi province. According to the Information Service of the State Administration of Grain Reserves, the price gap between the two rice markets was almost zero (figure 15). Interviews with private traders found that some traders from the Nanchang area sold their rice below cost in Guangzhou to preserve their market share.

Until 2 years ago, private trading firms' capacity for inter-provincial trade was limited. However, in late 1993 and early 1994, rice prices in south China rose rapidly and the state grain system delayed the release of the central reserve. This, together with policy reforms, opened the door for a dramatic expansion of private trade.

Private grain marketing had been suppressed for many years by the government. In 1978, when the reform started, the peasants were allowed to sell their grain products in local markets only after they fulfilled the compulsory quota. Beginning with the early 1950s, Government policy has never allowed private marketing to outplay the state grain system. In 1983 and 1984, when the success of the "household responsibility system" (or household land contract system) brought about nationwide grain surplus, the restriction on long distance trade for peasants was abandoned. However, when the market became tight in 1986, the practice of repressing peasant marketing was resumed. Since then, another two similar changes occurred as China's grain market experienced another two cycles from 1987 to 1996.

The recent growth of private rice marketing in south China has benefited from the interplay of some important policy reform and technical changes which have occurred in the last few years. The most significant policy changes favoring peasant marketing were: 1) the elimination of retail price subsidy for urban residents, 2) the elimination of planned transfers of grain among provinces, and 3) the decentralization and commercialization of the state grain system since 1993. These three policy changes created a much more open and competitive environment in urban areas. The original motive of these policy reforms was to reduce government fiscal burdens. Since the state grain system has monopolistic control over specialized storage facilities and enjoy other advantages in long-distance trade such as access to railway transportation, it was widely believed that private rice marketing would not threaten the dominance of the state system.

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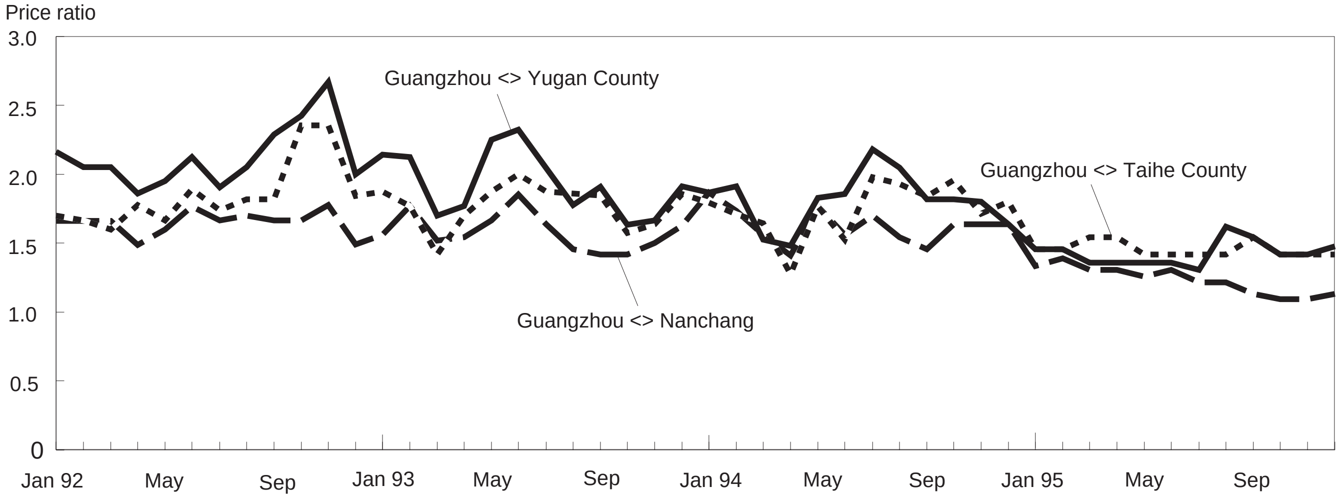
Figure 15
Rice price ratio between Guangzhou and three Jiangxi counties



Trucks and Telephones Supported Growth of Private Rice Traders

However, two major technical changes occurred in the 1990s which favored private rice marketing. One change was the significant cut in the cost of truck transportation. The ‘Dongfeng’ truck powered by a diesel engine was developed in China in the early 1980s. It had a specified 5-ton load capacity, but the truck can actually carry more than 10 tons with minor adjustments in the suspension system. Since early 1990, the trucks were sold in large quantities to private individuals, and competition in truck transportation intensified. The inventory number of agricultural use trucks rose dramatically from 430,000 in 1985 to 790,000 in 1995. As a result, state-owned truck companies were almost wiped out, and the use of privately owned Dongfeng trucks increased rapidly.

The overall transportation cost has decreased as per vehicle load increased. In Jiangxi province, the price for truck transportation was 0.20 renminbi (RMB) per ton/km in the 1980s, but increased to about 45 cents in 1996 while the overall retail price more than tripled during this period.[2]

The real price of truck transportation, therefore, decreased by more than 30 percent. The economic impact of this change was immense. The railway transportation bottleneck in south China was broken and the real price of railway transportation also declined because of the competition with truck transportation.

For the first time in China’s history, main surplus and deficit areas in south China were linked by competitive mechanized land transportation. For hundreds of years before modernization, rice markets in south China had been integrated by low cost water transportation. According to Professor Dwight Perkins, in the 19th century the price in the major deficit areas was about 30 percent higher than in the source area. However, in the early 1980s, the cost for shipping rice by truck from the main surplus area to the main markets was even higher than 30 percent. Now, because of the technical change, the cost for shipping rice by trucks in the same range has dropped to less than 15 percent of the original price. The cost of railway transportation is still lower than truck transportation, especially for long distances, but there are some disadvantages for those private traders who had no access to storage in the consumer market area. From their point of view the railway system was less flexible. It did not give them the ability to time shipments and to choose buyers. Therefore, the railway system tended to bring higher price risk in a volatile market environment. Because most private traders do not have storage space in consumer market areas, rice marketing by private firms in south China is dominated by truck transportation.

The second technical change favoring private marketing in China has been the recent development of modern telecommunication systems in urban and rural areas. The latest computerized telephone exchange system spread rapidly throughout China. Now, most populated rural areas are not only linked with urban areas inside China but have links to the rest of the world. Consequently, all rice traders in south China have good information about prices from his sources and market areas. This progress greatly reduced the price risk for small traders.

The improved telecommunication system also has contributed to lower truck transportation cost because it helps to reduce one-way shipping (for example, reducing the number of empty trucks returning to Hunan province). In many cities of south China, there are telephone services which help returning truckers find freight to haul back to their home bases.

Organizational Structures Simple

The size and organizational structure of most private rice marketing firms in south China are very small and simple. The core of most firms is a small rice mill, typically with capacity of producing 1 ton of husked rice per hour. New

[2]One renminbi (RMB) or yuan in 1966 equaled 8.3 U.S. dollars.

rice mills cost about 55,000 RMB (US$7,000), less than the cost of a middle-sized truck. Most firms have limited storage facilities in their rice mills. The firms usually are family owned or several partners work together, and these entities usually are located in rural market towns along the rice trading route. Some firms own one or more trucks, especially those firms founded by truck owners. Because truck transportation is always available, truck ownership has not been a condition for entry into this market.

The number of private rice trading firms has not been published, but a survey of seven towns in Jiangxi province revealed more than 200 private rice trading firms. The number of rice mills (private trading firms) tripled in the last 2 years. The processing capacity must be very large because the rice mills operated by the state grain system have almost closed down, so most demand for local consumption and shipping to other provinces have been met by small mills run by private firms. The number of small mills in Jiangxi province alone could be in the range of 2,000 with the capacity of processing more than 20,000 tons of rice each day. This estimate is very conservative because many mills owned by families were running under capacity even during the peak season of rice trade.

Private Grain Traders Hold Limited Stocks

The small size, low vertical integration, and vast number of these private trading firms are in sharp contrast not only with the state grain system in China, but also with the private trading firms in many market economies. The most striking feature of these private grain trading firms is that they hold extremely few commercial stocks. Most rice marketing firms are being run like the ‘Just In Time’ system invented by the Japanese Auto industry. The traders in surplus areas typically do not buy paddy rice from farmers until they receive an order from the wholesaler in the consumer market.

These organizational structures reflect the current social, political, and economic environment in China. The prominent feature of the environment is the high market risk associated with possible government intervention. Markets in surplus areas could be easily closed down by local government action in the name of protecting local interests or market stability. Or, market price in deficit areas can be affected by unpredictable intervention by local government such as importing from abroad or setting price ceilings. So keeping commercial stocks has been viewed as very risky for private traders.

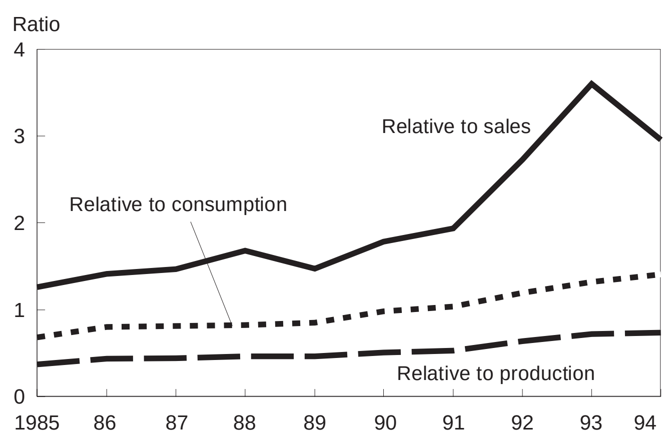
On the other hand, once the market was opened by the government, grain was usually available, at least for peasant marketing as a whole. The second main feature of the market environment is that the aggregate level of grain stocks by rural households has been persistently high since the decollectivization (4).

Taking Jiangxi province as an example, the average year-end grain stock in the last decade, according to the government survey, was about 16 to 18 months of its own consumption when the next harvest was only 8 months ahead (figure 16). The potential marketable rice (unhusked) from all rural households was about 4 million tons, equivalent to the total compulsory quota in Jiangxi province. This amount is also about three times that of the yearly urban consumption in Jiangxi and two times the average yearly rice transfers to other provinces in the last decade.

The elimination of planned transfers between provinces in 1993 made the grain stocks by the rural households more exposed to the inter-provincial trade. The rapid growth of peasant’s marketing capacity has been driven by this opportunity. A consequence of this process is that the state system began to lose its advantage in transporting and processing. The private firms increasingly gained business not only in the inter-provincial but also in the intra-provincial trade, because, under the financial pressure, more government grains were processed and transported by private firms. Even in the retail business, the market share by the state system has been shrinking steadily despite the lower farmgate price through compulsory quota. Besides the bureaucratic cost, the state system has to bear higher labor costs (including pensions for retired workers) and is subject to more stringent tax scrutiny. Therefore, when the new government purchase price squeezed out the implicit tax imposed by the compulsory quota, there was little room for the state grain system to stay in the rice market if the government does not want to subsidize rice retail sales.

The emergence of private firm rice marketing in south China raises a serious challenge to the longstanding assumption held by China’s policy makers that private rice marketing could not handle the requirements of urban markets in this modern age. The recent development in the rice market of south China shows that the advances of modern transportation and communication technologies actually produced great opportunities for a highly decentralized marketing system. The private firms have been successfully taking advantage of this new opportunity. The current organizational structure of China’s pri-

Figure 16
Ratio of rural household grain stocks to household production, consumption, and sales, Jiangxi Province, China



vate rice marketing is not yet mature, but it appears that private firms could well replace government marketing as a central player in China's rice market.

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