

TRENDS IN CHINESE FOOD DEMAND AND TRADE PATTERNS

Fred Gale
Senior Economist
Economic Research Service
U.S. Department of Agriculture

All eyes are on the China market. With one-fifth of the world's population and gross domestic product growing 9-10 percent annually, it is a big target and a moving target. China figures prominently in the plans of business leaders and policymakers.

Food has always been a central factor in the Chinese economy, its culture, and its politics, and remains important today. Food is the largest item in Chinese household budgets, accounting for 38 percent of the expenditures made by urban families and nearly half of rural household expenditures. The importance of food and the specter of famines in China's history elevate the importance of remaining self-sufficient in food in the minds of Chinese policymakers.

The changes in Chinese eating habits make China the world's most dynamic market for food, and perhaps the most important driver in world agricultural trade. The sheer size of the population means that changes in the China market could have repercussions in global agricultural markets.

As Chinese households gain greater spending power, they tend to cut back on consumption of traditional staple grains—mostly rice and wheat—and increase their consumption of nearly every other food item. Purchases of dairy products, poultry, fish and other aquatic products, soft drinks, wine, and processed foods are all growing rapidly. These consumption patterns are reflected in USDA estimates of grain consumption. Rice and wheat consumption plateaued in the last decade, but consumption of corn and soybeans has grown rapidly, reflecting an expanding livestock herd to feed Chinese consumers' increasing demand for livestock products.

Who is feeding this hungry dragon? With 20 percent of the world's population and less than 10 percent of the cropland, China has been surprisingly successful in feeding itself without relying heavily on imports. For decades, analysts have been forecasting robust growth in China's agricultural imports, but growth failed to materialize until the last three years. From the early 1990s until 2002, China's agricultural imports fluctuated around \$8-12 billion per year, with few signs of growth.

Finally, in 2003 and 2004, imports exploded, more than doubling to \$25 billion in 2004 and 2005. China is now the fourth-largest agricultural importer in the world (after the EU, United States, and Japan) and the fourth-largest market for U.S. agricultural exports (after Canada, Mexico, and Japan). U.S. ag exports to China reached \$5.5 billion in calendar year 2004. Has China's demand for food reached a "critical mass" where market opportunities are starting to multiply?

A closer look at the data shows that the opportunities have been created primarily in just a handful of markets. China's growing demand has been a major factor in the soybean and

vegetable oil markets, and its appetite for industrial raw materials has created demand for natural fibers, rubber, and hides. But it remains surprisingly self-sufficient in most food items.

There are several reasons why Chinese food demand may not have grown as fast as might be expected. First, Chinese consumers have many other spending priorities—housing, education, travel, leisure, health care, and automobiles—as they emerge from several decades of enforced austerity under central planning when consumer goods and services were not only unaffordable but also unavailable.

China's eye-popping GDP growth figures and futuristic city skylines may overstate the increase in the standard of living for the majority of the Chinese population. Incomes and food spending are rising at double-digit rates for the wealthiest tier of Chinese households, but growth has been well below GDP growth rates for the rural population and the lower tier of urban households.

Chinese consumers are spending a significant part of their extra food dollars on higher quality, not necessarily greater quantity. They are paying higher prices for brand name foods, processed products, meals in restaurants, and food certified to be free of dangerous chemical residues. This trend is magnified by the concentration of food spending growth in the upper tiers of the income distribution. Wealthy households tend to spend more on quality, while low-income households tend to spend extra food dollars on buying more milk, meat, fish, and fruit.

Another factor impeding ag imports in China is the low price of domestic food. Retail prices of nearly all foods in China are much lower than prices of imports. Imported apples, citrus fruit, and wine sell at prices far above those of domestic items and are niche market items purchased mainly as gifts or for special occasions.

Several other factors suggest that China will have to rely on imports to feed its population. With increasing demand for food quality, it is not clear that China can meet the challenge of supplying *safe* food. China has boosted both agricultural and industrial production side by side on a relatively small land base at the cost of dangerous contamination of foods with pesticides, antibiotics and industrial effluents. Further expansion of food production is likely to bump against the limits of China's natural resource base. Furthermore, Chinese consumers lack confidence in the safety of domestic food and tend to view imported food as more safe.

Spreading its new affluence more widely to the entire population is one of China's biggest challenges, but there are signs of success in this endeavor. Supermarket chains and food product distributors are moving from wealthy coastal cities into second-tier cities in China's interior. China's leadership is implementing a range of policies designed to raise rural incomes, building rural roads, increasing spending on rural schools and job training, and even subsidizing the expansion of supermarket chains into rural communities. As many as 200 million rural migrants spend most of their time working in cities and return home to their villages with extra cash and new consumption habits. All of these developments will strengthen economic linkages, diffuse new consumption and shopping habits to China's vast hinterland, and expand potential markets for imported foods.

China's accession to the WTO in late 2001 cut its agricultural tariffs to an average of 15 percent, one of the lowest in the world. But just as important is the more recent liberalization of the distribution and retail sectors. Greater openness and efficiency in distribution will make it easier for imports to get from the port to the Chinese consumer.

China's trade outlook for the 21st century appears favorable. Its increasing integration with the world economy, rising affluence, and resource constraints make China a promising market for agricultural imports. Rising domestic demand may curb China's exports of corn, fruits, and vegetables as well. Still, Western commercial interests have a long history of unrealized trade expectations in China and periods of openness have been interrupted by periods of isolation, so all forecasts should have a wide margin of error.