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Organic Products Market in China

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Report Highlights: Organic agriculture in China continues to move forward, with export and domestic markets growing in double digits annually over the past several years. China's organic farming acreage ranks first in Asia, and international markets include the U.S., EU, Korea, and Japan. Increased awareness about food safety, health, and diet, as a result of a number of public food safety problems, have supported development of organic produce markets in Shanghai, Beijing, and Guangzhou, as well as smaller Emerging Market Cities. Market growth continues to be driven by both domestic and global demand although certification and economies of scale remain major issues. The government sees the sector as an employment multiplier and strategic opportunity for sustained economic development.

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Summary

China has the potential to become a world power in the organic foods industry. Home to one-fifth of the world's population, a growing number of its Chinese consumers are making more health-conscious purchases. The country continues to attempt to increase organic export production as well as boost domestic demand. With the growth of the international market for organic products, some products in China are now being grown to international organic standards for export with the help of third-party global certification groups. Other products continue to target the domestic market with certification by local or provincial bodies. In 2003, the total turnover for the "Green Foods" market reached approximately \$11.9 billion or \$8.7 billion wholesale for the domestic market.¹ According to a report from the International Fund for Agricultural Development (IFAD), the value of Chinese organic exports grew from less than \$1 million in the mid-1990s to roughly \$142 million in 2003.

An initiative by the government to promote pure foods led to development of an organic food market that continues to show growth potential. Organic farms in China are beginning to resemble Western counterparts in farming practices, certification, and retail promotion. However, significant strides have yet to be achieved for the organic market to prosper. Problems facing organic products in China include lack of consumer awareness, high price elasticity of demand, distrust in the domestic enforcement of organic regulations and lack of educational and support services for farmers. Consumers in China pay close attention to whether or not a product is imported or grown in China. Chinese consumers favor some international food brands, as long as there is no large price difference from that of domestic brands. Organic foods could achieve favorable market share with the proper consumer awareness and if such awareness continues then future prospects should be bright.

Advantages	Constraints
High regard for food safety and health lifestyle	Lack of consumer awareness
Increasing number of international organic certification bodies	Consumer mistrust of domestic certification
Potential for high market share among U.S. exporters	Chinese are still very price sensitive

Regulations and Policy

Like everything in China, the definition of organic products is changing. Currently there are several different definitions of organic food employed throughout China, including "green foods" and "organic" labels. It is necessary to understand the difference between these definitions in order to better comprehend the Chinese market. China's economic reforms and the ensuing opening of the economy in the 1980's led to unprecedented growth in the diversity and variety of food available. However, food safety problems also increased, in part due to the improper application of chemical inputs during food production. As a result, in 1990 the Ministry of Agriculture created the "Green Food" program.

Initially "Green Food" was thought to be a replication of the western organic food standards, but in reality "Green Foods" use product standards rather than the process standards. "Green Food" products can incorporate limited amounts of chemicals and fertilizers, whereas chemicals may not be present in organic products. In the 1990's, "Green Foods" were divided

¹ The National Green Food Development Center does not formally track green food prices. Rather, unprocessed product farm gate and processed product wholesale prices are combined to determine wholesale values for "green foods." Total price is based on a 37% average markup on Chinese organic sales from wholesale to retail for 2004.

into two categories, A and AA. The A standard of inspection focused on production and control records, while the AA standard is more similar to international organic standards. Nevertheless, the general low quality of the products prevented the AA standard from being internationally recognized and accepted.

In China the “Green Food” label has enjoyed much success because of its focus on healthy living. However, the accomplishments of the green food movement in China have been an impediment to the development of the organic market. The Chinese government has supported green foods much more than organic products, as green foods are largely produced on state-run farms. On the other hand, international companies working directly with farmers and village cooperatives are the main producers of organic products.

In 2005, the Certification and Accreditation Administration of China developed the first Chinese National Standards for Organic Produce. By the end of 2006, labels will be required on all organic foods along with any international certifications. The expectation is that the new standards will allow green foods to meet international market standards, thereby making them ideal for the export market. For an unofficial translation of the current organic standards in China, please refer to GAIN Report CH5054.

There has been a dramatic jump in the number of organic certification bodies in China. In 2004, six organizations offered organic certification services. In 2005, this number increased to twenty-six. The foreign certification bodies are from the U.S., EU, Australia and Japan and focus directly on the export market. Numerous companies are opening up offices in China as the demand for certification continues to grow. Local and provincial governments are establishing export-oriented enterprises, but suffer from the lack of a coordinated certification approach. Consequently, many continue to focus on the growing domestic industry where standards are not as stringent as in the international market.

Organic Farms in China

According to the International Fund for Agriculture Development (IFAD), most organic farming production in China is managed by trading companies and farmers. Trading

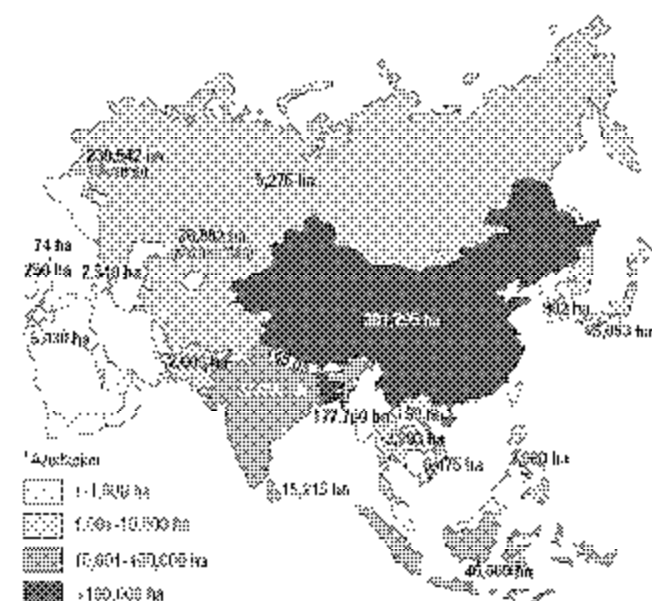


Figure 7: Organic agriculture in Asia
 In Asia about 293,000 hectares and more than 61,500 farms are under organic management.
 Source: IFAD Survey, February 2006; Compiled by GAIN, 2006

companies typically take on the lead and provide input access, technical advice, and marketing. This is in contrast to the organic sector in most countries, where farmers typically play a stronger role. This model is particularly dominant in coastal areas like Beijing, Shanghai, Guangzhou, etc., because trading companies and the government are more likely to have necessary connections to market products and the resources to convert polluted land for organic farming. This same corporate model holds true in poor regions as well where most farmers face production inefficiency, lack of organization, and limited market orientation.

In places such as Heilongjiang, great areas of land are dedicated to the cultivation of organic produce. It is expected that by 2010 over one third of the total agricultural land in production will

be converted to organic production. With organic farm acreage increasing nearly ten-fold over the last decade, China is well on its way to becoming one of the largest organic food producers in the world. Exports to markets like Japan, the world's largest organic food consumer nation, continue to grow.

In the opinion of Gerald A. Herrmann, Vice President of the International Federation of Organic Agriculture Movements (IFOAM), which promotes and certifies organic food, "organic agriculture holds great promise for both internal and export markets" in China. He goes on to state that by building on traditional farming practices, China will be able to move to an organic farming system while integrating efficient methods for increasing yields, conserving the environment and nourishing the population via a sustainable system of agriculture. However such highly positive predictions need to take into account the scarcity of resources such as potable water that are currently constraining the growth of organic farming in China.

Promotion of environmentally friendly agriculture is also increasing in China. It has become a key priority for the government, especially in efforts to safeguard food from contamination. One expert of the OFDC (Organic Food Development Center) sums it best when he says, "China's Organic farming aims to maintain long-term soil fertility through application of various sustainable cultivation techniques, developing diversified production systems, and reducing dependence on unnatural additives. With sustainable production systems, organic farmers contribute to the protection of natural resources. Organic growing practices follow written standards, which exclude the use of synthetic fertilizers and chemical pesticides. Organic food is free of chemical residues, healthy, and generally of high quality. Therefore, many consumers are willing to pay a premium for organic products."

The Chinese government may also view organic farming as a way to address the rural poverty problem. Supporters of organic farming argue that with lower production costs and higher prices, natural farming can help lift farm income. Industry insiders suggest that overseas buyers are willing to pay Chinese farmers at least 30 to 50 percent more for organic food. According to a series of studies conducted in China, India and six Latin American countries by IFAD, farmers in developing countries who switch to organic agriculture achieve higher earnings and an improved standard of living.

"The combination of local and export markets for organic products stands to elevate the income of small farmers dramatically. Organic farming practically eliminates the dependency on bought-in farm inputs (pesticides, synthetic fertilizers and others) thus improving farmers' economies substantially," echoes Herrmann.

The growth in demand for organic products in China is translating into the emergence of a new cadre of entrepreneurs. A Beijing teacher has had success with the organic-theme craze by investing in a large farm. Everything produced at her Bright Sun Orchard Farm in Tongxian, near Beijing, is grown without fertilizers. All fruits and vegetables are picked by hand for optimum quality control and much of the produce takes on a more natural appearance. Her clients include enthusiastic housewives of Beijing expatriates and locals.

Consumption Trends

An important factor to keep in mind is that not every Chinese consumer shops alike. Significant differences exist in spending habits across generations and geographic regions. Consumers in the over-35 age group tend to be more conservative and traditional in their food consumption habits, preferring to shop daily and sticking to local brands. While those under 35 tend to have higher disposable incomes and prefer to shop weekly because of active lifestyles. The under-35 group is also more familiar with Western products and foreign tastes, including the growing popularity for organic food products.

Despite these differences, there are general trends in Chinese consumption. Such trends are important to consider when looking at potential demand for the organic food market. One is a high level of price sensitivity. Consumers will often spend a great deal of time and effort in searching for a bargain. Brand loyalty carries little weight when it comes to shopping for foods. Price will often override any existing loyalties to specific stores. If an all-organic store were to be introduced in China, it might not equal the results of its U.S. counterparts. In some large cities, however, the demand for organics has been growing. All organic stores are making their entry into China. In late 2005, the O Store opened in Shanghai. It carries organic products from approximately 70 organic producers. In Beijing, the environmental group Friends of Nature has started offering weekly deliveries of in-season organic produce.

Today there is a greater focus on healthy living in China as many Chinese increasingly enjoy faster paced lifestyles. There is a growing emphasis on food essential to good health. However, consumer awareness of organic products benefit has yet reached the point where the all-important consumer price sensitivity would be sacrificed. The one child policy in China opens the door to marketing healthy organic products. With only one child to dote on, many families spend a large portion of disposable income on the healthy development of their child and future. In fact, a huge market potential exists if properly developed.

A common misconception is that the growth of the Chinese middle class will translate into a higher quantity of extra dollars spent on organic products. Many Chinese consumers lack awareness of the benefits of organic foods. Consumers of organic products tend to be highly educated and affluent. In China, this assertion also holds true, with a majority of organic consumers coming from the upper class. Disposable income among Chinese consumers has not grown to the point where organic products could control a significant part of the market. In the past, in-store promotional activities for food items have been successful, and might work in the promotion of organic products for middle class consumers. With urbanization growing in China, some cities like Beijing, Shanghai, and Guangzhou, have already developed to the point where organic products can have positive sales. Other cities have not reached this level of urbanization, and still require further development.

Consumption Stages

	Stage 1	Stage 2	Stage 3
Retail Environment	Shopping in wet markets, little sign of modern retail formats or international competition	Developing retail environment with a growing presence of modern domestic and international retailers	Modern retail environment, need for convenience shopping
Product Groups	Traditional staple food that is locally produced, food as a function rather than as a taste experience	Focus on value, increasing expenditure on health and beauty products	Luxury goods, customized products, value added products, brand promiscuity
Consumer Profile	Shop daily, low food expenditures	Will shop on a daily basis for fresh food, less likely to stock up on groceries, enjoys product promotions	High level of disposable income, quality important, prefers one-stop shopping

Challenges and Recommendations

Although generally optimistic, the organic movement in China is not without a number of significant challenges. Balancing productivity and profit can be a big challenge. Many farmers also suffer from lack of economies of scale, with operations too small to effectively reduce cost. Organic agricultural products are still a niche market in China, and suffer from limited consumer awareness and a lack of support networks.

The example of the Beijing Huabang Food Company illustrates such challenges. The enterprise specializes in the production of fruit juices and began developing its organic fruit plantations in 2002. Recently it abandoned two of its orchards in the Beijing suburbs, as the fruit proved to be too expensive for juice production. The company's organic ventures are now being concentrated on kiwi and wild hawthorn orchards in nearby Hebei Province. In addition to facing pricing difficulties, the Beijing Huabang Food Company also did not have access to support networks that could increase consumer awareness.

With limited output and missing support networks, most small farmers are unable to invest in further development. Without the ability to invest in high quality processing and packaging, these same farmers are prevented from moving into higher value added products. In addition, expert knowledge of organic agricultural techniques is currently very limited and the availability of training programs and qualified advisors are extremely small. "Many small farmers still face a number of obstacles to becoming certified organic producers, including lack of technical knowledge, inadequate market information, limited storage and processing facilities and complex certification processes," says Paolo Silveri of the IFAD.

The main problem with many of the current organic farms in China is lack of organization and insufficient knowledge regarding organic practices. Historically, the government did not encourage cooperation among farmers. Many family farms are limited in size, with the average farm size less than 1.25 acres. The successful organic farms in China have been large farms with access to significant amounts of capital. Also, China has only a few retail outlets dedicated solely to organic products, unlike the US where stores like Whole Foods have enjoyed tremendous success. Most organic food producers, moreover, are located in urban areas where food availability and sales outpace rural growth and supply. While the affluent in urban areas have the disposable income to afford organic, sales in many stores are modest because of inconsistent supply and a poor understanding about organic products.

One possible solution is to introduce better professional support services. For example, IFOAM, has been at the forefront of developing Internal Control Systems for smallholder producer groups. This enables small farmers to be certified as a group at a far lower cost than paying for certification individually. IFOAM is also strengthening the development of its Participatory Guarantee Systems for organic production, whereby organic farmers can utilize and develop their own standards, often based on IFOAM standards. Products are marketed locally and community involvement ensures respect for credible organic methods.

It is not yet clear how the Ministry of Agriculture plans to invest in organics. Several local and regional governments have expressed their commitment to supporting organic agriculture with some already invested in pilot projects and research. However, the future of organic farming lies in the hands of the economics of production. To most farmers, profitability is the determining factor. There is some indication the central government will continue its commitment to green food, and provide more financial incentives for farmers to switch away from heavy (chemical laden) production agriculture.

The sheer size and scale of China's economy presents a potentially large and thriving market for the organic food and agricultural product market, however significant challenges are yet to be overcome by producers and the retail distribution system.