

How Might China Protect Its Agricultural Sector?

Cheng Fang, Francis Tuan, and Funing Zhong

China has insulated its domestic food markets from foreign competition and world price fluctuations by maintaining tight control on agricultural trade. As China opens its agriculture to foreign competition after World Trade Organization (WTO) accession, will it protect its farmers?

Urban Subsidies Give Way to Farm Aid

From the 1950s through the 1970s, Chinese farmers were effectively taxed rather than subsidized. Under the centralized government procurement system, farmers were paid low prices for mandatory sales of commodities to the government. After rural reforms began in 1978, the government raised procurement prices to stimulate grain production while continuing to sell grain to urban consumers at subsidized retail prices. China's official statistical reports indicate that spending on price subsidies (mostly grain crops and some livestock products) was 71.2 billion yuan (\$8.7 billion) in 1998, up from 7.9 billion yuan in 1979. Until the 1990s, most of these subsidies accrued to urban consumers and processors that paid subsidized prices, sometimes below the price paid to farmers. Low commodity prices benefited urban consumers and yielded government revenues from export sales and taxes paid by agroprocessors' profits. As urban residents' income and agricultural production increased over the past two decades, widespread urban food subsidies became unnecessary and taxation of agriculture began to disappear.

In the late 1990s, the government tried to boost farm incomes by procuring grain at above-market support ("protective") prices. In some years, China maintained prices of important commodities, such as wheat, soybeans, and corn, substantially above international levels by keeping a tight reign on imports through unannounced quotas and license requirements, maintaining government monopolies on import and export of commodities, subsidizing exports, and taking other measures (fig. I-1). Input subsidies and government

support for infrastructure and research also aided the agricultural sector.

Still, not all commodities in China are subsidized. Some commodities have prices below international levels (negative protection). Rice, a staple food and a source of modest export revenues, is the most notable example. Some argue that overvaluation of the Chinese currency in the years after the 1998 Asian financial crisis (when the central government resisted pressure to devalue) hurt farmers by reducing the effective cost of products from competing countries. Finally, there have been concerns that central government subsidies have been absorbed by the bureaucratic grain marketing system or offset by rising local taxes and fees assessed on farmers. Data on local taxes and fees are scarce, but estimates indicate that local agricultural taxes and fees amount to 25 percent of farmers' net income. Thus, on the whole Chinese farmers are still taxed, although the level of taxation is lower than in the past.

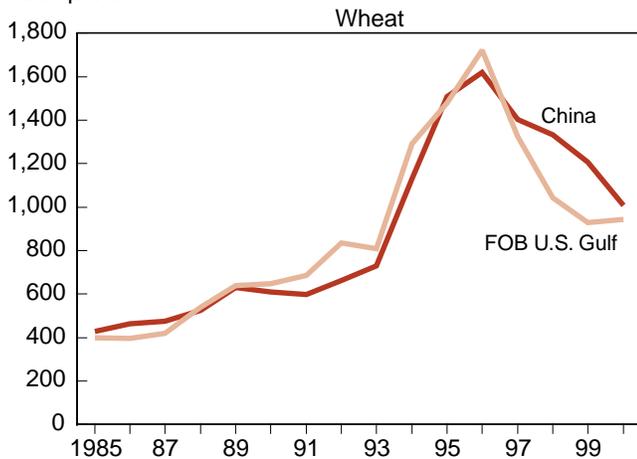
Open Markets Will Challenge Farmers

China's protection of agriculture has relied on strict control of agricultural trade, but China's WTO accession will substantially reduce tariffs on most agricultural products, eliminate export subsidies, and loosen state control over imports and exports. The government will also be required to publish information about import quotas and regulations. Trade in commodities previously dominated by state trading entities will be opened to nonstate trading companies. Tariffs on nongrain products will range from 3 to 20 percent. Imports of grains, cotton, vegetable oils, wool, and sugar will be allowed to enter at minimal tariff rates up to set limits—tariff-rate quotas (TRQ)—from 2002 to 2004. Soybeans and soymeal will have bound tariffs of 3 percent (soybeans) and 5 percent (soymeal). By comparison, the world average tariff for food and agricultural products is 62 percent (U.S. Department of Agriculture). The terms of China's

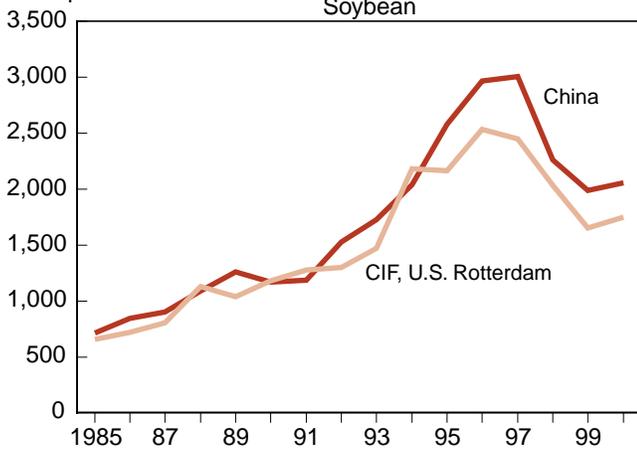
Figure I-1

China farm gate and world reference prices, 1985-2000

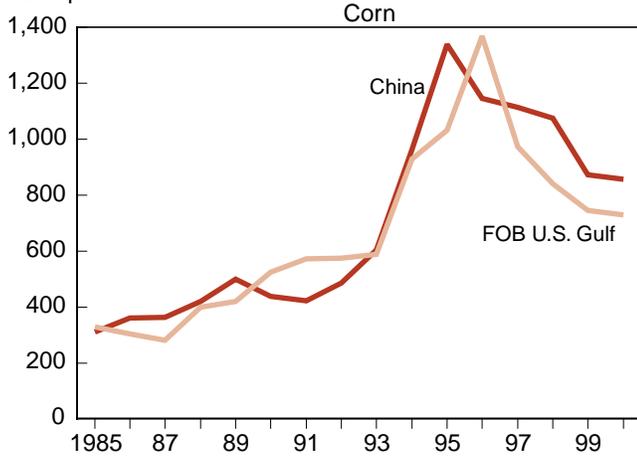
Yuan per ton



Yuan per ton



Yuan per ton



Source: China Price Bureau and International Monetary Fund, International Financial Statistics.

What We Need to Know

What is the long-term self-sufficiency level for China's agriculture?

Could regional liberalization of grain self-sufficiency affect China's overall agricultural protection?

Which "boxes" and what measures will be used after the WTO accession?

Who will provide funds for subsidies to farmers: central or local governments?

WTO accession could make it one of the most open countries in the world in terms of agricultural trade.

In a more liberalized agricultural trade environment, China's government will likely search for ways to protect agriculture to maintain grain self-sufficiency; stabilize domestic markets in the face of droughts, floods, and world price fluctuations; support farm incomes; and preserve social stability. China's farmers are internationally competitive in many commodities, but the country's corn and cotton prices were substantially above world levels at the time of China's WTO accession. Impacts on Chinese farmers of open markets will likely be modest and gradual, but China may implement policies to mitigate adverse effects of WTO accession since roughly half of its population relies on agriculture.

Self-Sufficiency Main Concern

Self-sufficiency in grain has been the government's main concern in formulating China's agricultural production and trade policy. WTO accession will not threaten self-sufficiency—now defined in China as meeting 95 percent of domestic food grain needs—in the near term. China has produced all of its own rice (and has been a net exporter) for the past two decades, and that trend is likely to continue in the near future. Even if TRQs for wheat and rice were to be entirely filled in the years following China's WTO accession (which many expect to be unlikely), grain imports would still be well below 5 percent of consumption.

In the longer term, market forces may bring about structural adjustments within the agricultural sector, such as movement of resources out of grain production and into more labor-intensive crops that use less land. The small scale of farms prevailing in China makes

producing grain less profitable than producing high-value products, such as horticultural crops or livestock. In the long term, it is possible that market forces could push imports of food grain past the 5-percent threshold. China will likely continue to produce most of its own grain even without subsidies, but government leaders may institute policies, at least for the next several years, to keep grain self-sufficiency below the 5-percent threshold.

Subsidies: Room for Growth

Concerns about low rural incomes or excessive reliance on imports could motivate China's government to increase subsidies for agriculture through price supports, income transfers, and indirect subsidies. The Uruguay Round Agreement on Agriculture (URAA) classified price supports as an "amber-box" trade-distorting policy, the use of which should be limited. As part of its WTO commitments, China agreed that the value of its trade-distorting amber-box support for agriculture would not exceed 8.5 percent of its total value of agricultural output (China's *de minimis* exemption). China's current amber-box support is minimal, so there is considerable potential for China to provide price support to farmers while remaining within its WTO commitment. Internal budgetary constraints are likely to keep subsidies far below the committed level. The 8.5-percent annual threshold based on China's current crop output value would amount to \$14 billion.

The URAA placed no limits on "green-box" subsidies, which do not directly distort trade. These subsidies include government-supported research, disease control, infrastructure, and policy subsidies for certain grain marketing and promotion services. The green-box category also includes income-support payments made directly to farmers that do not stimulate production, assistance to help farmers restructure agriculture, and environmental and regional assistance programs. Green-box payments must come directly from

taxpayers and cannot involve transfers from consumers. China will likely use green-box subsidies to further improve infrastructure and research, develop and import new grain varieties and technologies, address water shortages, and adjust agricultural production structure. Spending on these programs will also be constrained by availability of funds.

China's agricultural policy is devolving to some extent to the provincial level. In wealthy areas in coastal provinces, provincial governments are looking at possible approaches for subsidizing farmers within their provinces. Grain-deficit coastal provinces have now eliminated government-set procurement prices and are relying on markets to determine grain prices. Government procurement prices are still set for key commodities in grain-surplus provinces in China's central and northeastern regions. China will face a great challenge in protecting incomes of the huge number of farmers in the poorer central and western provinces that are still heavily dependent on agriculture.

Further Reading

- Tuan, Francis, and Guoqiang Cheng. "A Review of China's Agricultural Trade Policy, 2001," Presented at International Agricultural Trade Consortium, San Francisco, CA, 1999.
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- World Trade Organization. "Agriculture: Fairer Markets for Farmers," WTO Web site, www.wto.org/english/thewto_e/whatis_e/tif_e/agrm3_e.htm
- World Trade Organization. "Agreement on Subsidies and Countervailing Measures ("SCM Agreement")," WTO Web site, www.wto.org/english/tratop_e/scm_e/subs_e.htm