

Agricultural Policy Reform in China

How have previous policy reforms changed agriculture?

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Introduction

China is the world's sixth largest economy and its most populous country, home to 1.3 billion people or 21% of the Earth's total population. But it faces a major challenge in providing its people with food – China has only 10% of the world's arable land and only one quarter of the average world water resources per person.

Agricultural reform has therefore been a major pillar of the fundamental economic reforms undertaken by China since 1978, resulting in a gradual transition from a centrally planned economy towards a socialist market economy. The commune system was replaced by one where individual families lease land from the collectives, ensuring that almost all rural households have access to land. Then, rural industries started to expand and absorbed a large part of farm labour. The reforms have achieved a sharp rise in agricultural production together with a dramatic fall in poverty and a significant improvement in the amount and quality of food available.

These changes have provided a major contribution to China's remarkable overall economic performance in the past 25 years, which has seen growth in real GDP average above 9% between 1990 and 2004 with even more rapid growth in trade and investment. China's accession to the World Trade Organisation (WTO) in 2001 confirmed a further strengthening of the reform course it has been following for the last 25 years.

A unique element of China's experience is that the bulk of the shift in employment has taken place within the rural economy, as agricultural workers moved to newly-developed non-agricultural industry, rather than through migration from rural to urban areas.

This Policy Brief provides an overview of the agricultural policy reform in China, its impacts on agriculture, the challenges facing the sector and the suggested directions for further policy reforms. ■

How have previous policy reforms changed agriculture?

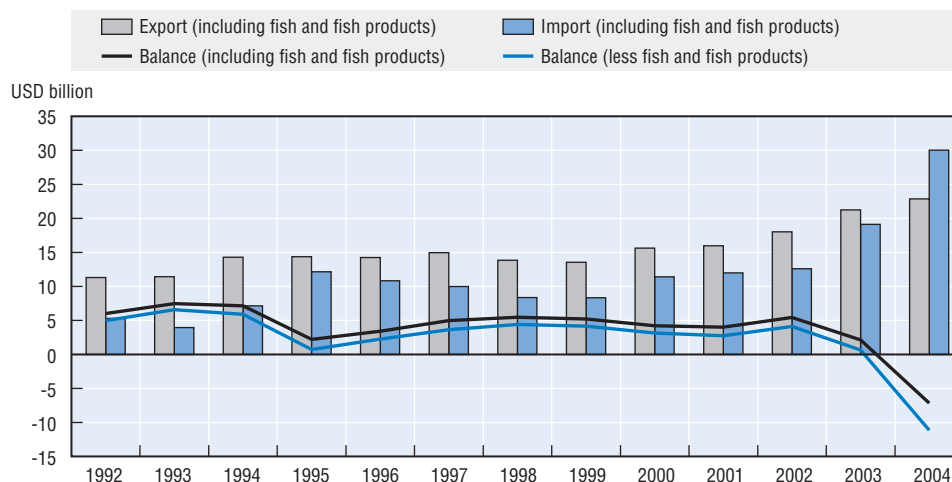
During the reform period China’s agriculture sector experienced phenomenal rates of growth. The introduction of the Household Production Responsibility System (HPRS), where families lease land from the collectives, boosted production incentives, encouraged farmers to reduce costs, take risks, and enter new lines of production. At the beginning of the 1990s, when the economy grew very rapidly, consumers shifted their preferences from quantity to quality. A new phase of adjustments started in the late 1990s and in the early 2000s when oversupply emerged on most agricultural markets, causing grain prices to fall, and increased exposure to international competition stimulated further structural changes. The main policy objective shifted to raising farmers’ incomes.

While cereals remain the key crop, their share in total crop production and in the area sown has declined quite substantially since the early 1990s as other crops became more profitable and the government relaxed most of the policy measures which had previously required farmers to produce grains. Impressive increases in vegetable and fruit production reflect China’s comparative advantage and responsiveness to changes in domestic demand, as well as to emerging export opportunities for selected products such as garlic, onions, apples, and pears.

China’s agriculture is characterised by scarce land, abundant labour and small-scale production using little mechanisation. The overwhelming majority of crop production originates from tiny farms averaging just 0.65 ha – in 2005, there were some 200 million of these. While a large part of livestock production also comes from small, part-time “backyard” operations, full-time “specialised” household operations and commercial operations have grown rapidly.

Agricultural output per unit of land is high by international standards but output per worker is low. Limited arable land and a large rural labour force mean that in general China tends to have a comparative advantage in producing labour-intensive crops such as fruits and vegetables and a

Figure 1.
CHINA’S AGRICULTURAL TRADE, 1992-2004



Sources: Comtrade database; China Customs Statistics for 2004.

disadvantage in producing land-intensive crops such as grains and oilseeds. However, the situation is quite strongly diversified regionally and depends on availability of land and water, climatic conditions, transportation costs and access to markets.

The land tenure system is based on land lease contracts. Farmland is *de facto* owned by village collectives which extend 30-year land lease contracts to individual farm households. Households can use, sub-lease and transfer the land, but they cannot sell it.

In the early stages of reform, land tenure policies were based on the HPRS and the principle of egalitarian access to land brought a number of positive effects. Compared to the communal system, the HPRS provided farmers with stronger rights to land and to production, which stimulated growth in agriculture and rural incomes. Through equal distribution of land use rights, China avoided having large numbers of rural landless workers vulnerable to famine or other economic shocks. It has also ensured that the vast majority of rural households are, at minimum, food self-sufficient.

However, the current land tenure system is increasingly revealing its limitations. Land market transactions are limited and land rental arrangements between farmers tend to be informal, short term and most often between relatives. There is also scope for arbitrary decisions by local leaders, and for conflict situations to arise between village leaders and farmers, including when local regulations limit land transfer rights. There are also a large number of cases when local leaders, assuming the role of landowners, decide to lease or sell land to external investors without consensus from local farmers and without farmers receiving proper compensation for lost access to land.

The agro-food sector (including fisheries) remained a net export earner at about USD 5 billion a year until 2002. In 2003 and 2004, following several consecutive falls in grain production and having overcome some early problems with the implementation of the tariff rate quota (TRQ) system agreed within the WTO, agro-food imports increased at high rates leading to net imports of agro-food products at about USD 11 billion in 2004 (Figure 1).

One of the remarkable achievements of the reform period has been the strong growth of real per capita rural incomes, largely due to the rise in non-agricultural employment opportunities. Real rural income rose more than three-fold between 1980 and 2000. The overall rise of incomes in rural areas, including those in poor areas, has led to a dramatic fall in poverty. This is all the more important since some 99% of China's poor live in rural areas. Using China's standard of income below USD 0.6-0.7 per day, the number of people living in poverty fell from 250 million in 1978 to 29 million in 2003. In other words, the proportion of the rural population affected by poverty fell from 31% to 3% during the period. Based on the World Bank definition of poverty (income of USD 1 per day), the number of people living in poverty in rural China was still high at 88 million in 2002, but the progress in eliminating poverty is still remarkable, with about 400 million people rising above the poverty line between 1979 and 2002.

China's rural poor are mostly concentrated in the western provinces and in localities that lag in terms of growth, are remote, sparsely populated, poor in human and natural resources, and weakly linked to the rest of the economy. This makes further reduction of poverty more difficult and partly explains a relatively slow fall in poverty levels since the mid-1990s. Moreover, rural communities just escaping from poverty are quite often strongly dependent on weather conditions and are likely to fall into poverty again when these conditions deteriorate. As the social security system is almost non-existent in rural China, little public assistance is available to those families which suffer most.

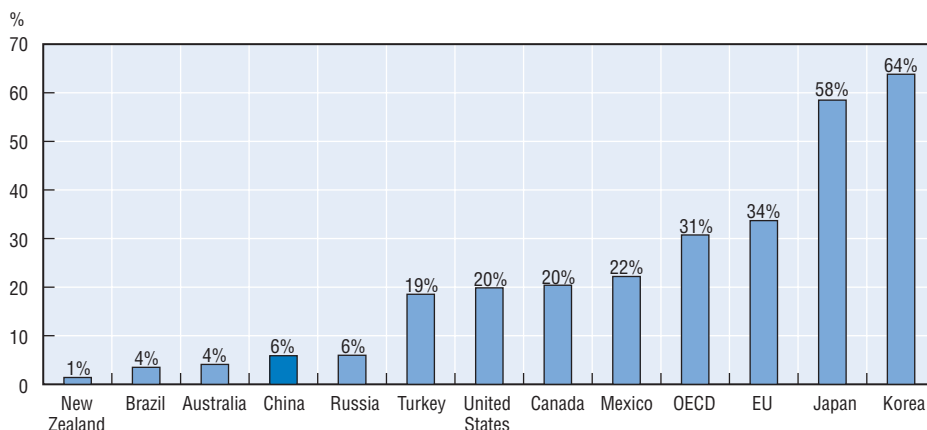
Despite the rapid reduction in poverty levels, overall the rise in rural incomes was not sufficient to close the gap with urban areas as differences in labour productivity between agriculture and the rest of the economy and, more generally, between rural and urban areas persisted. In fact, the income gap has widened as the reforms progressed. Per capita income in urban areas was 1.85 times that in rural areas in the mid-1980s, but by 2003 and 2004 the ratio had risen to 3.2, the highest over the whole reform period. ■

Can current growth continue?

The high rates of agricultural production growth obtained over the first two and a half decades of the reform period cannot continue indefinitely. Prospects for further substantial gains in agricultural labour productivity will likely depend on labour moving away from agriculture to other sectors of the economy. This will secure higher incomes for those remaining in the agricultural sector and those leaving should benefit from higher incomes due to more efficient use of labour in non-agricultural sectors. In fact, the income distribution across rural areas in different parts of China depends increasingly on the availability of non-agricultural job opportunities in rural areas and on people moving to urban areas in search of work. As the availability of jobs is highly uneven, the variation in per capita income by province is much greater for rural than for urban areas.

In the past, China had boosted food production by increasing the amount of land being used for agriculture. In recent years, however, the area of

Figure 2.
PRODUCER SUPPORT ESTIMATE IN CHINA AND SELECTED COUNTRIES, 2000-2003 AVERAGE
As per cent of gross farm receipts



Note: EU15.

Source: OECD PSE/CSE databases 2005.

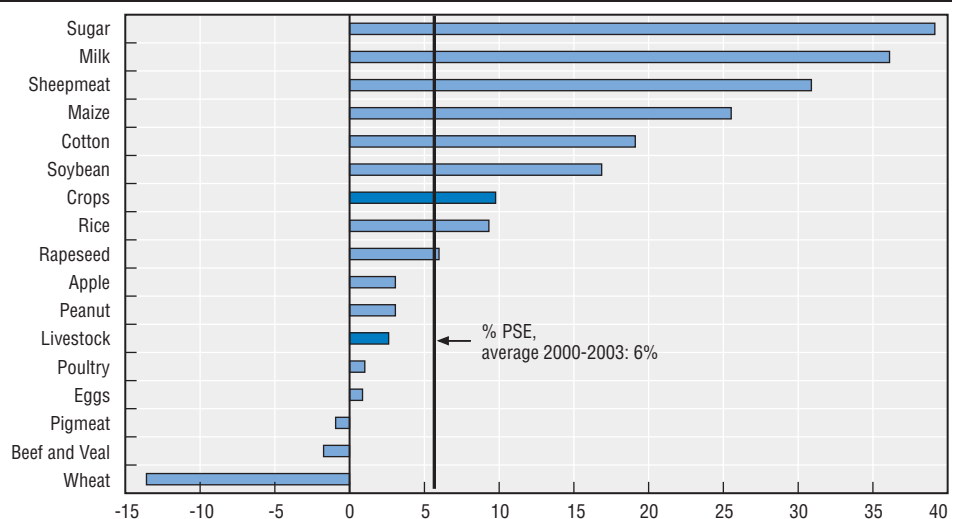
cultivated land has been decreasing, and the focus has been on using more fertiliser, pesticides and mechanical inputs to increase productivity. But this more intensive chemical-use system of farming is creating its own problems. China's use of fertilisers, at 280 kg per hectare, is one of the highest in the world. Urban and industrial growth have also put pressure on agricultural land and water resources, while agriculture is itself directly affected by pollution from other human activities, especially industrial production. Some of the ecological problems are location-specific, such as desertification in northern China, whereas others are common across the country, such as land degradation, soil erosion and water pollution. These problems risk contributing in the long term to a reduction in agricultural productivity. ■

Are current policies effective?

China does provide support for its farmers, but well below the levels of its closest OECD neighbours, Japan and Korea, which are also its main export markets for agro-food products (Figure 2). The level of policy support to China's agriculture, measured according to the OECD's Producer Support Estimate (PSE) fluctuated at low levels through the 1990s, rising to 6% of gross farm receipts in 2000-2003, little less than a fifth of the OECD average of 31%. However, the mix of measures used to support China's farmers is dominated by price support and input subsidies, among the least efficient and most trade-distorting ways of providing agricultural assistance.

And while overall producer support is low, the level varies significantly. The highest levels of support are for commodities facing competition from imports, such as sugar, milk, sheep meat, cotton and soybeans, as well as some export commodities such as maize and rice (Figure 3). The distortions on grain markets are still relatively high, mostly due to state trading, which continues to drive a wedge between domestic and world prices. In contrast, for the majority of exportables, such as pig meat, beef and veal, eggs, peanuts and apple, the level of support is low.

Figure 3.
CHINA'S PRODUCER SUPPORT ESTIMATE BY COMMODITY, 2000-2003 AVERAGE
As per cent of gross farm receipts



Source: OECD PSE/CSE databases 2005.

A slightly different picture emerges using the Total Support Estimate (TSE), the broadest indicator of support which in addition to PSE includes expenditures for general services, such as agricultural infrastructure, and direct budgetary transfers to consumers. Total support to China's agricultural sector reached USD 41 billion per year in 2000-2003 which is equivalent to 3.3% of China's GDP in this period. This percentage is much higher than the OECD average and suggests a relatively high burden of agricultural support on the Chinese economy. However, it also reflects the economic importance of agriculture in a relatively poor economy, and is partly due to large budgetary investments in agricultural infrastructure, to improve productivity. These expenditures are a positive feature of China's policy as such support has desirable long term impacts and minimal distorting effects on production decisions and on trade. ■

How would more open trade benefit China?

Any world agreement to further open up agricultural trade would improve China's access to overseas markets, raise world market prices for agricultural commodities, and generate income *gains* for China's farmers. At the same time, higher world market prices lead to higher costs for consumers of some agricultural goods, although some domestic consumer prices would fall with a reduction in China's own agricultural tariffs as part of a multilateral market opening agreement.

But agreement to further open up world agricultural markets would not have much effect on China's overall welfare. Net trade constitutes only a small fraction of China's agricultural output, and the gain in farm incomes would be just about the same as the consumer loss due to higher prices.

Reductions in the tariffs OECD countries charge on non-agricultural merchandise could, however, mean significant welfare gains for China, both in its agricultural and non-agricultural sectors, without increasing the adjustment pressures associated with the current trend of net migration from rural to urban areas.

Using this analysis to simulate the welfare effects of multilateral trade liberalisation on a sample of rural Chinese households, it was found that welfare would improve for the vast majority (91%) of them. Welfare changes might be substantial, at 2.8% of pre-reform income levels for the average household in the sample. The very few who would lose out from reform typically live in communities poorly endowed with agricultural potential, physical infrastructure and human capital. ■

What are the main policy challenges for the future?

As the economic situation and sectoral performance have improved, government priorities have shifted from increasing production, especially of food grains, to rural income support and more recently to environmental concerns. In the medium term, the main challenges for China's policy makers include:

- closing the large income gap between rural and urban populations;
- integrating small-scale farmers into markets;

- stimulating internal reallocation of resources to create more efficient farm structures;
- reducing the negative impacts of agricultural production growth on the environment;
- improving the competitiveness of agricultural and food products on domestic and international markets;
- improving the governance of institutions in designing and implementing agricultural policies.

Policy responses should be based on economy-wide measures such as further relaxation of administrative barriers to rural/urban migration, improved access to education in rural areas, better health care, pension and other social security services, enhanced land property rights and rural tax reforms. The provision of modern research and extension services, food safety agencies and agricultural price information, services which provide widespread benefits to producers and consumers throughout the economy will also be of crucial importance. ■

For further information

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For further reading

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