

## CHAPTER 4

### CHINA

#### Evaluation of policy developments

- A rural-urban divide with large and growing income disparity further accentuated by differences in access to education, health care, pensions and other social benefits, has been a striking feature of China's impressive economic growth.
- Benefiting from continued strong economic growth and relatively good fiscal position, China's government has been allocating more budgetary resources to rural areas, including to agriculture.
- The level of support to agricultural producers (the PSE) remains low compared to the OECD average. It tended to increase, in particular at the beginning of the 2000s, but then stabilised between 2003 and 2005.
- China's support to agriculture is dominated by market price support and input subsidies, the least efficient and most trade distorting ways of providing agricultural assistance. Only a small part of this type of support is effectively received by producers.
- State trading still plays an important role in driving a wedge between domestic and world prices for selected commodities. In particular, export-import decisions for cereals are still made by the government and driven by the level of strategic stocks and expected production trends of various grains rather than by prospects of profits based on price differentials. This leads to the situation that e.g. wheat is imported when domestic prices are lower and maize exported when domestic prices are higher than those on the world markets.
- China's intention to focus on economy-wide policies such as education, health care system and social security to reduce the rural-urban divide is a welcome step. However, as grain security remains a key policy objective there is a risk that a large part of support will be diverted to grain producers instead of the rural population at large.
- The dominating top-down decision making process based on a traditional approach "we know what is good for you" undermines local initiatives and leads to conflict situations. Chinese farmers should be able to organise themselves on the basis of autonomous large scale peasant organisations to communicate and protect their own interests, e.g. in terms of land tenure rights, provision of public goods or marketing of agricultural commodities.

## Summary of key policy developments

1. Rural development became China's priority in recent years. However, while rural-urban divide is of major concern, grain security remains a key factor having a strong impact on policy measures applied. In 2004, the government introduced minimum prices for selected grains, initiated direct payments to grain producers, and applied subsidies for the purchase of higher quality grain seeds and selected machinery. These policy measures were also applied in 2005 and 2006. To support farmers' incomes, agricultural tax reform was gradually implemented and declared as completed at the beginning of 2006.

- Support to producers (%PSE) increased from 3% in 1995-97 to 9% in 2003-05. This compares with the OECD average of 30% in 2003-05.
- Market Price Support (MPS) accounted for 43% of the PSE in 2003-05 compared to 32% in 1995-97.
- Despite almost three-fold real increase in budgetary support to producers, its relative importance has declined.
- Consumer support (%CSE) was negative at minus 5%, meaning that consumers were implicitly taxed in 2003-05. This compares with the tax at minus 2% in 1995-97.
- Prices received by producers were on average 5% higher than those received in the world markets in 2003-05 (*i.e.* the NPC was 1.05) and for such commodities as cotton, sugar, and maize even more than 10% higher. In contrast, producer prices for wheat were almost 10% lower than on the world markets.
- Support provided to general services for agriculture almost doubled in real terms between 1995-97 and 2003-05, but its share in the TSE fell from 50% to 34%.
- Total cost to the economy (%TSE) increased from 1.89% in 1995-97 to 2.52% in 2003-05 and was higher than the OECD average of 1.14% in 2003-05.

Figure 4.1. PSE level and composition over time

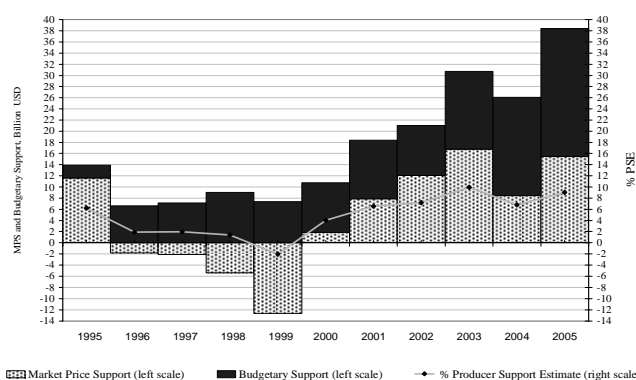
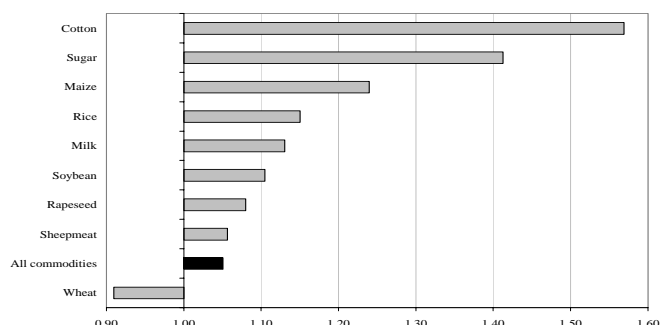
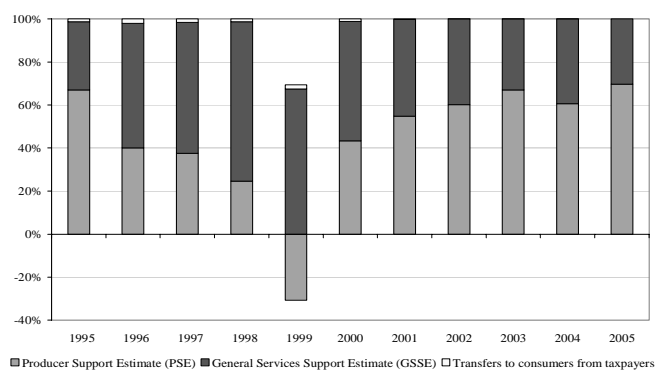


Figure 4.2. Producer NPC by commodity, 2003-05 average



Note: NPCs amounted to 1 for eggs, poultry, pigmeat, beef and veal, apples and peanuts.

Figure 4.3. TSE composition over time



**Table 4.1. China: Estimates of support to agriculture**

(CNY million)

	1995-97	2003-05	2003	2004	2005
<b>Total value of production (at farm gate)</b>	<b>1 996 250</b>	<b>2 921 510</b>	<b>2 440 890</b>	<b>3 031 220</b>	<b>3 292 420</b>
<i>of which share of MPS commodities (%)</i>	<i>75</i>	<i>60</i>	<i>61</i>	<i>60</i>	<i>58</i>
<b>Total value of consumption (at farm gate)</b>	<b>1 997 135</b>	<b>3 127 693</b>	<b>2 698 029</b>	<b>3 208 958</b>	<b>3 476 091</b>
<b>Producer Support Estimate (PSE)</b>	<b>65 946</b>	<b>261 664</b>	<b>254 158</b>	<b>216 008</b>	<b>314 826</b>
Market Price Support (MPS)	21 353	111 854	139 042	69 994	126 525
<i>of which MPS commodities</i>	<i>17 841</i>	<i>66 720</i>	<i>84 951</i>	<i>42 155</i>	<i>73 054</i>
Payments based on output	0	0	0	0	0
Payments based on area planted/animal numbers	0	8 267	0	11 600	13 200
Payments based on historical entitlements	0	0	0	0	0
Payments based on input use	31 830	64 090	44 976	57 500	89 793
Payments based on input constraints	3 471	51 414	46 862	51 994	55 386
Payments based on overall farming income	9 292	26 040	23 278	24 920	29 922
Miscellaneous payments	0	0	0	0	0
<b>Percentage PSE</b>	<b>3</b>	<b>9</b>	<b>10</b>	<b>7</b>	<b>9</b>
<b>Producer NPC</b>	<b>1.01</b>	<b>1.05</b>	<b>1.08</b>	<b>1.03</b>	<b>1.05</b>
<b>Producer NAC</b>	<b>1.04</b>	<b>1.09</b>	<b>1.11</b>	<b>1.07</b>	<b>1.10</b>
<b>General Services Support Estimate (GSSE)</b>	<b>60 013</b>	<b>134 156</b>	<b>124 829</b>	<b>140 616</b>	<b>137 021</b>
Research and development	3 813	4 112	3 626	4 032	4 679
Agricultural schools	4 203	14 052	12 381	14 358	15 417
Inspection services	1 181	3 330	2 837	3 388	3 764
Infrastructure	21 432	56 632	53 720	56 760	59 417
Marketing and promotion	0	0	0	0	0
Public stockholding	29 384	56 029	52 264	62 079	53 746
Miscellaneous	0	0	0	0	0
<b>GSSE as a share of TSE (%)</b>	<b>50.1</b>	<b>34.2</b>	<b>32.9</b>	<b>39.4</b>	<b>30.3</b>
<b>Consumer Support Estimate (CSE)</b>	<b>-29 397</b>	<b>-132 129</b>	<b>-191 029</b>	<b>-60 789</b>	<b>-144 569</b>
Transfers to producers from consumers	-13 533	-129 965	-172 565	-75 019	-142 310
Other transfers from consumers	-12 223	-15 857	-39 837	7 613	-15 347
Transfers to consumers from taxpayers	2 101	116	128	128	93
Excess feed cost	-5 743	13 576	21 245	6 489	12 995
<b>Percentage CSE</b>	<b>-2</b>	<b>-4</b>	<b>-7</b>	<b>-2</b>	<b>-4</b>
<b>Consumer NPC</b>	<b>1.02</b>	<b>1.05</b>	<b>1.09</b>	<b>1.02</b>	<b>1.05</b>
<b>Consumer NAC</b>	<b>1.02</b>	<b>1.05</b>	<b>1.08</b>	<b>1.02</b>	<b>1.04</b>
<b>Total Support Estimate (TSE)</b>	<b>128 060</b>	<b>395 936</b>	<b>379 115</b>	<b>356 752</b>	<b>451 940</b>
Transfers from consumers	25 755	145 821	212 402	67 405	157 657
Transfers from taxpayers	114 528	265 971	206 550	281 733	309 630
Budget revenues	-12 223	-15 857	-39 837	7 613	-15 347
<b>Percentage TSE (expressed as share of GDP)</b>	<b>1.89</b>	<b>2.50</b>	<b>2.79</b>	<b>2.23</b>	<b>2.47</b>
<b>GDP deflator 1995-97 = 100</b>	<b>100</b>	<b>115</b>	<b>108</b>	<b>116</b>	<b>120</b>

Notes: p: provisional. NPC: Nominal Protection Coefficient. NAC: Nominal Assistance Coefficient.

Market price support is net of producer levies and excess feed costs.

MPS commodities for China are: wheat, maize, rice, rapeseed, soybean, peanuts, sugar, apple, cotton, milk, beef and veal, sheepmeat, pigmeat, poultry and eggs. NPC: Nominal Protection Coefficient. NAC: Nominal Assistance Coefficient.

Source: OECD, PSE/CSE database, 2006.

## **Policy context**

2. Agriculture is an important sector of China's economy, but while its share in total employment is high at 39.5%, its contribution to GDP is much lower at 12.5%. This indicates a large gap in labour productivity between agriculture and the rest of economy. Agriculture is also less integrated with global markets than other sectors of China's economy as indicated by its just 3.6% share in China's total exports and 4.3% share in imports. The share of food in total living expenditures has been falling as real incomes continue to grow at high rates, but was still high at 37% for urban households and at 46% for rural households in 2005.

## ***Macroeconomic situation***

3. China's GDP expanded by 10.2% in 2005, with growth in the first half of 2006 accelerating to 10.9%, despite measures designed to cool the economy. China's GDP reached USD 2.2 trillion in 2005 making the country the world's fourth-largest economy, behind the USA, Japan and Germany.

4. Consumer price inflation slowed from 3.9% in 2004 to 1.8% in 2005 and to just 1% in July 2006 year-on-year, partly due to stronger food output. Real incomes continued to grow rapidly in 2005 with a rise of 9.6% per head in urban households and 6.2% in rural households, thus indicating that the rural-urban income gap increased again.

5. In July 2005, China adopted a new exchange rate regime for the Yuan (CNY), scrapping its peg to the USD and replacing it with a managed float against a basket of currencies. The Yuan appreciated initially from CNY 8.28 to CNY 8.11 per USD and then to CNY 7.97 per USD by the end of August 2006. This modest appreciation is partly due to the government's concerns that a faster rate could increase pressures on China's farmers making agricultural imports cheaper (EIU, 2006).

6. China's fiscal deficit was modest at 1.7% of GDP in 2005. Current account surplus widened to USD 161 billion in 2005, driven mostly by the trade surplus, and foreign-exchange reserves increased to almost USD 1 000 billion by October 2006, equivalent of about 18 months of imports.

7. Despite impressive economic performance, China's policy makers face major challenges such as the growing rural-urban divide, strong inter-regional differences in economic development, growing pressures on environment, ageing of the population, and growing dependence on energy imports.

## ***Agriculture and agri-food situation***

### ***Output***

8. In 2005 China recorded a sound growth of Gross Agricultural Output (GAO) at 2.9%, of which crop output increased by 2.1% and livestock output by 4.6% (Figure 4.4). The rates slowed compared to 2004 when rising agricultural output prices by 13.1% accelerated overall output growth to 6.4%, including that for crops by 6.7% and for livestock products by 5.7%. In 2005 output prices increased by just 1.4% indicating that commodity prices in China stabilised after sharp increases at the end of 2003 and in 2004. The 2005 increase in output prices compares unfavourably with the increase in input prices of 8.3%.

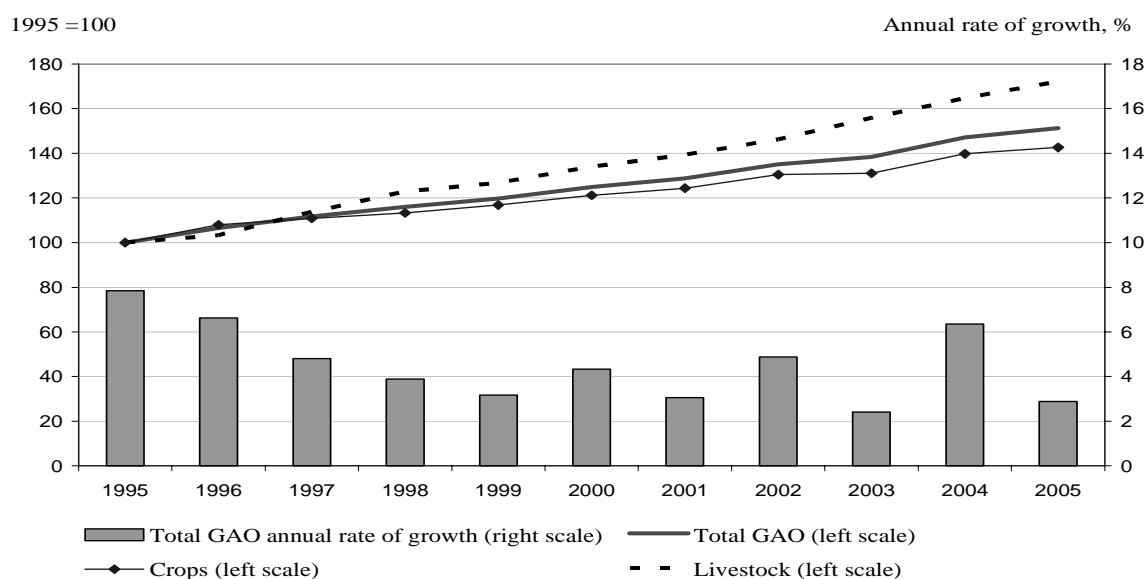
### ***Crops***

9. In 2005, China's cereal production increased for the second consecutive year. This was the result of stronger grain prices in the preceding two years and a set of new policy measures applied by the government alerted by a fall in grain production between 1998 and 2003 and a corresponding decline in grain stocks. Total cereal production increased by 3.9% to 428 million tonnes (484 million tonnes in line

with Chinese definition of grains which includes soybean). Area sown to grains increased by 3.3% in 2004 and again by 3.2% in 2005 to a total of 81.9 million hectares, reversing the falling tendency between 1997 and 2003.

10. While vegetable and fruit production continued to increase at high rates, performance of other crops was weaker. Cotton production declined by 9.7% in 2005, largely due to a fall in area sown by 11.1%. The fall in production to 5.7 million tonnes combined with a strong demand from the textile industry, contributed to a record import of cotton at 2.7 million tonnes in 2005. Sugar cane and sugar beet production decreased by 1.2% and oilseeds production remained at the 2004 level.

**Figure 4.4. Evolution and annual changes of agricultural output in China, 1995-2005**



Source: Calculated from FAO data.

### Livestock

11. Driven by strong demand, livestock production continues to develop rapidly. Total meat production amounted to 77.4 million tonnes, up 6.9% over the 2004 level. Milk production was low in the past, but since the end of the 1990s has doubled every 3-4 years. In 2005 it grew by 21% reaching 28.7 million tonnes.

12. Pork remains the key meat produced, but reflecting changes in consumer preferences, its share in total meat production dropped to 65%, while the share of poultry meat increased to 20% and that of beef and sheepmeat to 15%. Regional specialisation strengthened with pig production dominating along the middle-and-low valley of Yangtze River, beef in central and Northeast China, sheep in Northwest prairie and central and Southwest China, and poultry in coastal developed eastern regions.

### Structures

13. Agricultural production structures are dominated by small-scale farming. There are about 200 million farm households with an average land allocation of just 0.6 ha per household. While crop production remains fragmented, livestock production becomes more concentrated with large-scale

commercial operations accounting for 38% of total pigmeat, 58% of milk, 30% of beef, 44% of sheepmeat, and 53% of egg production in 2004 (*China Livestock Yearbook*, 2005).

14. Farmland is *de facto* owned by village collectives, which extend land lease contracts to individual households. Farmers' land use rights have been strengthened with the extension of land lease contracts up to 30 years, but there is still a large scope for conflict situations between farmers and various layers of authority (OECD, 2005). In particular, low compensation for lost access to land has become one of the main reasons for peasants' discontent. As urbanisation and industrialisation advance, the total number of farmers who lost access to land could amount to 40-50 million (Zhao, 2005). Surveys indicate that farmers receive just 5-10% of the final price of land transferred for other uses, local government 20-30%, various enterprises 40-50%, and village committees 25-30%. To protect farmers' economic interests, many legislative initiatives were undertaken by the government over the recent years, but their implementation has been weak.

15. Concerns over the need to maintain a high level of self-sufficiency in food production, in particular of grains, motivate the government to protect so called "basic farmland" area, which according to the 11<sup>th</sup> Five year Plan should not fall below 120 million hectares by 2010 from the current 122 million. This leads to various measures to tighten the control over the conversion of basic farmland for non agricultural uses in particular for commercial, industrial or residential development purposes.

#### *Inputs*

16. Scarce land and abundant labour motivate farmers to maximise land productivity through intensive use of labour and variable inputs, in particular fertilisers, pesticides and water. As capital remains scarce, the level of mechanisation is in general low. The average use of chemical fertilisers in active substance per hectare of sown area increased to 302 kg in 2004, which is one of the highest in the world and makes agriculture one of the key water polluters (Box 4.1).

#### **Box 4.1. Why do Chinese farmers overuse chemicals?**

Application rates of chemical fertilisers have increased almost four-fold since 1980 and China now ranks among countries with the highest intensity of fertiliser use in the world. Pesticide use has increased even more rapidly. While growing use of chemicals has played an important role in increasing agricultural production, it can also increase production costs, augment the risk of certain food quality and food safety problems, and contribute to environmental pollution. In fact, agriculture has become the main source of non-point water pollution in China. In turn, water pollution contributes to water shortages and increases the cost of water provision for agriculture.

Several recent studies have shown that chemical fertilisers are now over-applied at rates between 20 and 50%. For pesticides, the over application rate appears to be even higher, at between 40 and 55%. In research currently underway, the Centre for Chinese Agricultural Policy in Beijing has found that there were no significant yield losses on plots where fertiliser use was reduced by 25 to 35%. A number of hypotheses may explain this phenomenon. It may be that for some farmers the over application of inputs is part of a risk management strategy. There is also some circumstantial evidence that land tenure and migration play a role in the pattern of excess application of chemicals. When migrant workers return home, they often apply inputs "all at once" rather than in optimal amounts at critical times in the growing cycle because the time they have during their home visits is limited. But the study also shows that there is even more evidence that the government, scientific community, plant breeders, extension agents, and input suppliers have convinced farmers that "if a little bit is good, a lot is better".

While these findings are tentative, they suggest that incentives within the existing research, extension, education, and agricultural input suppliers need to be re-examined. In particular, they suggest that information farmers receive is biased due to vested interests of input suppliers. It is not counterbalanced by adequate information about the merits of reducing input use, both in terms of increasing farmers' income and of decreasing environmental damage. Such information should be provided through research, education, and extension services.

*Source: Huang et al., 2006 and OECD, 2006.*

17. China's WTO accession and lower tariffs on imports eased access to high quality imported inputs and stronger competition had led to a fall in input prices by 2003. Moreover, new marketing channels for input supplies developed in addition to the earlier existing Chinese Supply and Marketing Co-operative system. However, both in 2004 and in 2005 input prices increased as the upstream sector benefited from stronger output prices while fast growing oil prices on global markets were transmitted to fuel and fertiliser prices. To curb the rise in input prices, the government took measures in 2005 to stimulate domestic production of inputs (especially of fertilisers), to increase imports and to discourage exports of fertilizers (see below).

#### *Food industry*

18. Food industry expanded by 26.9% and accounted for 8.2% of China's industry output in 2005. Its profits increased by nearly 30%. The industry ranks first in world production of such products as edible oil, beverages and beer.

19. The industry is still very fragmented with some reports suggesting that the total number of food processing enterprises is around 0.9 million (Taylor, 2005). This compares with only about 20 thousand medium and large enterprises with annual sales in excess of CNY 5 million each (USD 0.6 million; NBSC, 2005). The industry is undergoing intensive restructuring with many enterprises expanding their activities and improving efficiency. However, high value added processing is still rare.

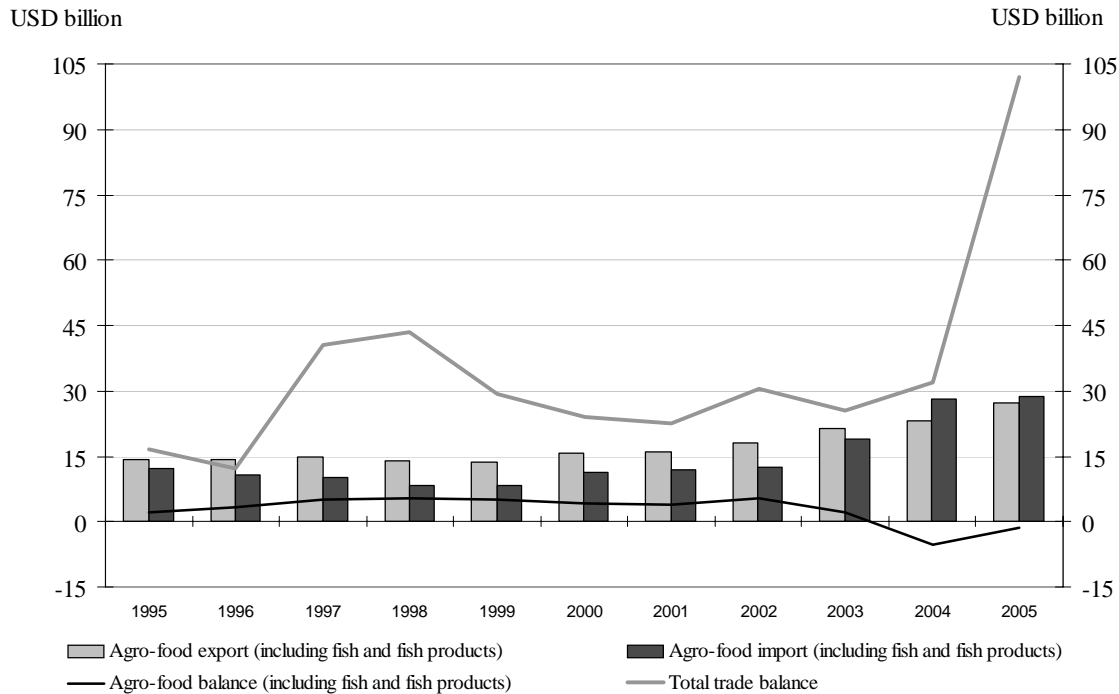
20. Food processing enterprises play a key role in the commercialisation of production by small-scale farmers, contribute to the development of local economy and absorb part of rural surplus labour, in particular in central and western provinces. So called "company plus farmers" model is becoming more and more popular, which is one of the newly developing downstream channels. On the basis of a contract, the company provides seeds, advice and technology while farmers deliver raw commodities in line with the company's requirements.

#### *Agro-food trade flows*

21. For the first time since the late 1970s, China's agro-food trade balance changed from net export to net import position in 2004. Rising grain prices on domestic markets in the last quarter of 2003 and in 2004 urged the government to buy 7 million tonnes of soft and durum wheat to replenish strategic stocks. Sharply increasing wheat imports combined with fast growth in imports of soybeans and cotton contributed to net imports of agro-food products at USD 5.1 billion, while agro-food exports reached a record value of USD 23 billion. In 2005, China remained a net importer of agro-food products but the deficit shrank to USD 1.5 billion as exports continued to grow at high rates and imports stabilised (Figure 4.5).

22. The fall in net trade deficit was driven mainly by changes in cereal trade flows. Following much stronger grain crops in 2004 and 2005, China resumed large-scale exports of cereals which more than doubled in 2005 to the total of 10.1 million tonnes. In particular, exports of maize almost tripled amounting to 8.6 million tonnes. Imports of cereals, mostly of wheat and barley, were still high at 6.3 million tonnes, but less than 9.8 million tonnes imported in 2004. As a result, China's net imports of cereals of 5 million tonnes in 2004 turned to net exports of 3.9 million tonnes in 2005.

**Figure 4.5. Agro-food trade in China, 1995-2005**



Source: Comtrade database.

23. Imports of soybean and cotton reached record levels in 2005, amounting to 26.6 million and 2.7 million tonnes, up by 31% and 35%, respectively. Sugar imports amounted to 1.4 million tonnes, up by 15%. Currently, China is the biggest buyer of soybeans, cotton and wool in the world. Exports of fruits and vegetables continued to grow rapidly, confirming earlier observed tendencies for China to specialise in exports of labour intensive products and to import land intensive products, in particular soybeans (Table 4.2).

**Table 4.2. China's agro-food export and import structure in 2005, by category of products**

	Export share (%)	Import share (%)
Cereals and oilseeds	14.9	46.4
Fishery products	27.7	10.1
Horticultural products	27.4	5.4
Livestock products	12.9	4.8
Other (including cotton)	17.1	33.3
Total	100.0	100.0

Source: China Customs Statistics.

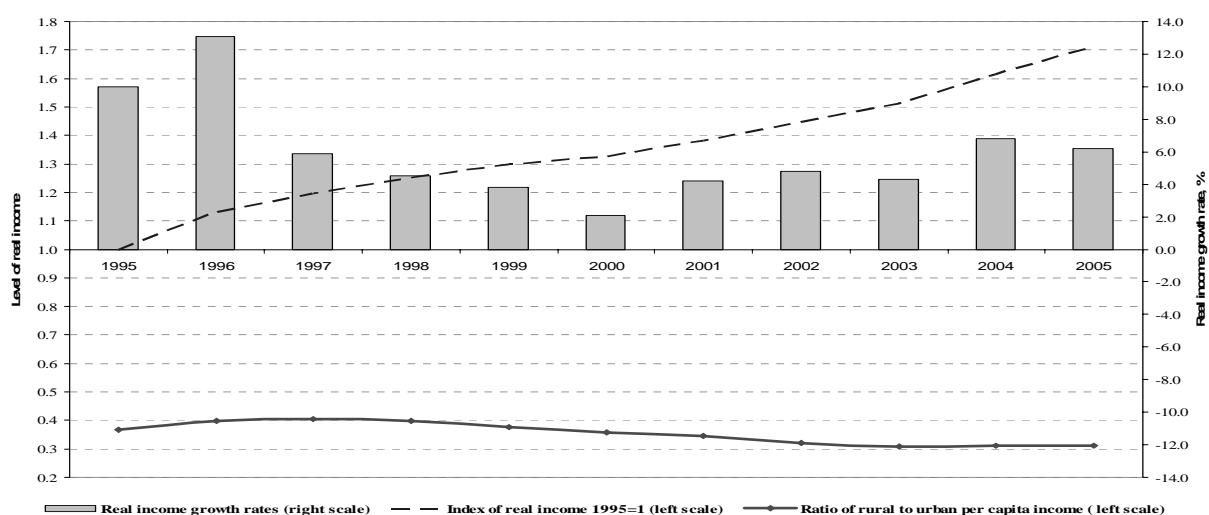
24. Exports to Asia in 2005 constituted 70% of China's agro-food exports. Japan remains the largest single export market for China, accounting for 29% of the total, followed by South Korea, USA, Hong Kong and Germany. The largest single supplier is the USA accounting for 24% of China's agro-food imports in 2005, followed by Brazil and Argentina. These three countries are the main soybean exporters

to China. The USA is also a key supplier of cotton, accounting for around one-half of China's cotton imports in 2005. Australia is the main provider of livestock products and wool and Malaysia of palm oil and rubber.

### Rural – urban divide

25. Real rural incomes rose more than three-fold between 1980 and 2000, representing an annual rate of about 6%. This led to a remarkable fall in the number of people living below the absolute poverty line (World Bank definition of USD 1 per day per person at the purchasing power rate) from about 490 million at the end of the 1970s to 88 million in 2002. However, of those defined as poor, some 99% live in rural areas (OECD, 2005). At the end of the 1990s and at the beginning of the 2000s, the rate of growth slowed to below 5% and as urban incomes continued to grow at higher rates, the rural-urban income gap increased (Figure 4.6). In 2004 and 2005, the rates of rural income growth accelerated to 6.8% and 6.2%, respectively, which was just sufficient to stabilise the level of the gap. The rural-urban income divide is further emphasised by strong differences in access to education, health and social security systems, drinking water, basic sanitary facilities, and finance institutions.

**Figure 4.6. Rural household income per person, 1995-2005**



Source: China Statistical Yearbook, NBSC, various editions.

### Domestic agricultural policies

26. Grain security, farmers' income and rural sustainable development are major concerns of China's government in recent years. For the three consecutive years of 2004-06, "No. 1 Documents", the top priority documents adopted jointly at the beginning of each year by the Central Committee of the Communist Party and the government, concentrated on agriculture and the countryside. The document for 2004 focused on "boosting growth in farmers' income", for 2005 on "strengthening comprehensive production capacity of agriculture" and for 2006 on the construction of the "new socialist countryside" (Box 4.2).

#### **Box 4.2. Construction of the new socialist countryside**

Document No. 1 for 2006 outlined a new rural development strategy. As the publication of this document coincided with the first year of the 11<sup>th</sup> Five-Year Plan, the priorities set there were further developed in the plan and their implementation will be extended until 2010. The plan sets three most important objectives: ensure adequate supply of grains and other agricultural products; steady increase of farmers' income; and the harmonious development of rural society. The following measures are envisaged to achieve these objectives:

First, speeding up the development of rural infrastructure such as roads, electricity and water supply, water conservancy, communication, rural schools and clinics, sanitation systems. In particular, it is planned that the problem of unsafe drinking water for 100 million rural habitants will be resolved and that 1.2 million kilometres of roads will be constructed or renovated by 2010.

Second, improving access to basic public services in rural areas through the gradual extension of 9-year compulsory education and the development of a cooperative healthcare system. In addition, a social security system for farmers would be established to include poverty relief and assistance and rural pension system for elderly people. From 2006, 9-year compulsory education in Western rural areas has been exempted from tuition and free compulsory education in all rural areas is to be achieved by 2010. From 2006, both central- and local-governments increased substantially subsidies for medical care in rural areas. Currently, a rural cooperative healthcare system covers 40% of the rural population and it is planned that by 2010 the system will cover the whole rural population.

Third, making efforts to raise farmers' incomes. This will include enhancements for the development of agricultural production capacity, encouraging the development of village and township enterprises, and speeding up the migration of rural labour to urban areas. The plan assumes a 5% yearly growth rate of real farmers' income and a transfer of 25 million rural workers to urban areas.

Fourth, improving capacity for increased grain production. Hard goals to be achieved by 2010 include grain output of 500 million tonnes (including soybeans) and not less than 103.3 million hectares sown to grains. For this purpose, the government will enhance the direct subsidy policies for grain producers and reinforce the construction of farmland water conservancy, drainage and irrigation systems.

Fifth, deepening institutional reforms in rural areas. These will include setting up of rural self-governance mechanisms, and development of farmers' autonomous organisations such as cooperative economic organisations and professional associations.

#### ***Price and income support policy***

##### *Minimum purchase price*

27. Before 2004, state pricing accompanied by a state procurement system was in place for major agricultural commodities. From 2004, centrally set state pricing only applies to tobacco, which remains under a state monopoly.

28. In May 2004, China allowed qualified non-state firms to buy and sell grains on the opened market. Private firms which meet certain criteria were also permitted to engage in grain processing and storing activities (OECD, 2005). The government regulates the grain market through national grain stocks, state trading enterprises (see below) and minimum purchase prices. The minimum prices were first announced in 2004 for early rice and japonica rice at CNY 1 400 (USD 169) and CNY 1 500 (USD 181) per tonne, respectively. The same level of prices was maintained in 2005. However, as market prices in both years were above the minimum level, there was no need for government intervention.

29. In 2006, new minimum prices were announced and the coverage was extended to include wheat. The level of prices per tonne was as follows: CNY 1 440 (USD 180) for white wheat, CNY 1 380 (USD 173) for red wheat, CNY 1 400 (USD 175) for early indica rice, CNY 1 440 (USD 180) for middle

and late indica rice, CNY 1 500 (USD 188) for japonica rice. As wheat market prices fell below the minimum levels, China's government designated state-owned warehouses in six major wheat producing provinces to buy wheat at minimum prices. According to some analysts, these purchases accounted for over 80% of farmers' total sales and nearly 40% of total wheat production in 2006 (eFeedLink).

#### *Direct payments*

30. Grain producer subsidies based on planted area were introduced nationally in 2004, usually at the rate CNY 10 (USD 1.2) per *mu* (1/15 ha) of area sown to rice, wheat or corn. In total, funding of CNY 11.6 billion (USD 1.4 billion) was appropriated from the state grain risk fund for this purpose. The Ministry of Finance allocates the funds to special provincial accounts at the Agricultural Development Bank of China and the provincial governments then disperse the money to county level accounts based on production levels and land use rates, determined at the provincial level. To ensure that farmers benefit from the government subsidies, the sub-national governments are required to publicise all details about the use of the grain risk fund monies and penalties are in place for inappropriate use of those funds. The system was continued in 2005 and 2006 at the total cost of CNY 13.2 billion (USD 1.6 billion) and CNY 14.2 billion (USD 1.8 billion), respectively.

31. While politically popular, the role of these subsidies in supporting farm incomes is minor. It is estimated that of total increase in rural incomes by 6.8% in 2004, direct subsidies accounted for only around 5%, 49% was attributed to increased product sales and 43% to non-farm income sources (Gale *et al.*, 2005).

#### *Elimination of agricultural taxes*

32. Until the beginning of the 2000s, Chinese farmers paid different formal and informal taxes, charges and fees. In 2000, officially recorded agriculture-related taxes (agricultural tax, animal husbandry tax, tax on special agricultural products, tax on the use of cultivated land, and contract tax) amounted to CNY 46.5 billion (USD 5.6 billion). However, farmers also paid contributions to the township government (*Five Tongchou*) amounting to CNY 26.8 billion (USD 3.2 billion) and to village committee (*Three Tiliu*) amounting to CNY 35.2 billion (USD 4.3 billion) as well as various fees estimated at around CNY 90 billion (USD 10.9 billion). If all these payments are also taken into account, the taxation shouldered by farmers, known as the "peasant burden", would be as high as between CNY 180 billion (USD 21.7 billion) and CNY 220 billion (USD 26.6 billion), or more than 10% of farmers' net annual income (Aubert and Li, 2002).

33. The rural tax reform, initiated in 2000, and progressively implemented from 2003, attempts to address the issue of high tax burden for farmers. It started from incorporating most agricultural taxes, fees and charges into one tax and then capped the tax at a maximum rate (8.4%) relative to the annual grain-equivalent value of agricultural output for the previous years. Reform included the removal of the Animal Slaughter Tax and of the Special Agricultural Tax on all products except tobacco. In addition, the government announced in 2004 that the Agricultural Tax would be phased out over five years, beginning in 2004. In March 2005, the government announced that agricultural tax reform should be further accelerated with the aim of phasing out all national farm taxes in 2006. In 2005, 28 provinces exempted farmers from agricultural taxes and at the beginning of 2006 China totally eliminated national agricultural taxes that had been implemented for 2 600 years.

34. While rural tax reform provides more transparency and helps increase farmers' disposable income, there are two main threats to its sustainability. First, the success of reform depends on continued tax revenue transfers from central government to provinces and counties as compensation for lower sub-national tax revenues. Second, the official value of the "peasant burden" seems to be underestimated,

which means that transfers from the central government will not fully compensate for various payments imposed on farmers by townships and village committees. Thus, it is rather unlikely that local authorities will discontinue collecting miscellaneous informal fees, levies and fines, in particular as farmers remain poorly organised and are weak partners vis-à-vis heavy and largely unreformed local administration.

### ***Input subsidies***

35. To lower prices of chemical fertilisers, fertiliser producers have been given access to lower priced inputs, such as electricity. The rates are differentiated across provinces but for example in 2002 fertiliser producers paid between 10% and 30% less for kilowatt hour than other industrial enterprises (OECD, 2005). In 2004, the price for chemical fertilisers increased by 12.8% which absorbed part of the producer price increase. To avoid that such situation repeats in 2005, the government undertook three measures. First, export taxes were increased to curb exports. For the period from 1 June to 31 October 2005 (a peak period for the utilisation of fertilisers), the tax was at 30% and then from 1 November to 31 December 2005 at 15%. Second, a cap on the sale price of chemical fertilisers in the domestic market was set. Third, to encourage production, fertiliser producers were temporarily exempted from VAT. Despite these measures, fertiliser prices increased by another 12.8% in 2005 (NBSC, 2006).

36. Since 2002, farmers benefit from subsidies for purchasing improved quality soybean seeds. In 2004 and 2005, this scheme was extended to cover also improved seeds of wheat, corn and rice. The budgetary allocations for this purpose amounted to CNY 2.85 billion (USD 0.3 billion) in 2004 and CNY 3.87 billion (USD 0.5 billion) in 2005 (RDI, 2006).

37. The government provides a small subsidy for the purchase of farm machinery. This subsidy mainly assists a small number of large farms of sufficient scale to warrant mechanisation. Benefits of this subsidy may accrue indirectly to the small-holders through reduced costs faced by farm service providers, such as harvesting companies.

38. According to official estimates, Chinese farmers' benefits from the cancellation of special product tax, reduced agricultural tax, direct payments to grain producers, subsidies paid to improved seeds and for agricultural machinery amounted to CNY 45 billion (USD 5.4 billion) in 2004 and to CNY 70 billion (USD 8.5 billion) in 2005 (Chen, 2006). In mid-April 2006 the government announced CNY 12.5 billion (USD 1.5 billion) worth of additional subsidies for grain producers to offset the rising cost of diesel fuel and fertilisers (*People's Daily*, 12 April 2006).

### ***Preferential credit***

39. Until the end of the 1990s, preferential loans were provided mostly to state marketing organisations to fund purchase and storage of key agricultural products, in particular grains. In the 2000s, most of these programmes were discontinued. In February 2006, the Agricultural Development Bank of China (ADBC), the so called "policy bank" implementing government programmes, announced that the commercial rates will also be applied to the grain marketing enterprises.

40. Preferential rates are now applied for loans targeting rural development and poverty alleviation. In 2006 the rates were just above half the commercial rates. However, there is evidence that loan funds are diverted to supplement sub-provincial government budgets and that loans are made to industrial enterprises and not necessarily benefiting the poor (OECD, 2005).

### ***Payments for returning farmland to forests***

41. The so-called "grain for green project" and officially titled the Returning Farmland to Forests Programme was launched in 1999. Under this programme, cultivated lands in environmentally fragile areas

are “retired” from crop production and converted to pasture or forest. Participating farmers are provided with grains and cash subsidies according to the area of damage-susceptible land they “retire”. For each *mu* retired, farmers in the upstream regions of the Yellow River basin in northern China received yearly 100 kg of grains and CNY 20 (USD 2.4) in cash; and in the upstream regions of the Yangtze River basin they received 150 kg of grains and CNY 20 (USD 2.4) in cash. In 2004, the grain allocation was converted to a cash equivalent. The period for which “retired” land is subsidised is set at two years for land returned to pasture, five years for land converted to “economic” forests and eight years for land converted to “ecological” forests. Free seedlings are also made available for afforestation (OECD, 2005).

42. Between 1999 and 2005, within this programme trees were planted on about 9 million hectares of cultivated land at the total cost born by the central government of CNY 103 billion (USD 12.4 billion; State Forestry Administration, 2006). Sharp increases in grain prices and concerns over grain security led to a significant slow down in the implementation of the programme in 2004 from a planned 3.3 million hectares to 0.7 million hectares. In 2005, the converted area was still small but increased to 0.86 million hectares. In line with the 11<sup>th</sup> Five Year Plan, CNY 137.7 billion (USD 17.3 billion) will be allocated for this programme between 2006 and 2010.

### ***Overall budgetary support to agriculture***

43. Under the Chinese budgetary accounting system, the government expenditures for agriculture consist of four major items, namely expenditures on rural production, rural capital construction, agricultural science and technology promotion, and rural relief funds. In 2005, these expenditures amounted to CNY 245 billion (USD 29.9 billion), of which those on rural production accounted for 73% of the total, rural capital construction for 21%, science and technology promotion funds for 1%, and rural relief funds for 5%. While overall expenditures for agriculture increased by 5% compared to 2004, their share in the total budgetary expenditures in China fell to 7.2% from 9.7% in 2004 (NBSC, 2006).

44. The growing expenditures, at least in nominal terms, seem to confirm the government’s commitment to allocate more resources to rural areas, but it is difficult to assess the actual level of budgetary support to rural development, including to agriculture. While all budgetary expenditures from various government bodies should be included in the data provided by the Ministry of Finance, it is difficult to verify if it is the case as a large part of expenditures comes from various special funds being under the responsibility of various ministries and government institutions. They include the National Development and Reform Commission, Ministry of Finance, Ministry of Science and Technology, Ministry of Water Conservancy, Ministry of Agriculture, State Administration of Forestry, China Meteorological Bureau, Ministry of Land Resources, State Council Poverty Alleviation Office, State Office for Preventing Flood and Drought, Ministry of Communication, Ministry of Health, Ministry of Culture and Ministry of Civil Affairs. Moreover, each ministry has its own system of channelling funds from the centre to the village level (Zhang, 2006).

45. Another difficulty is linked with the Chinese concept of three *nongs* (agriculture, farm and countryside), which can be defined in various ways thus resulting in various estimates of total budgetary allocations to support agricultural (in fact rural) development. Moreover, information on budgetary expenditures is very aggregated and in many cases the coverage of payments within a given programme is so large that it is impossible to separate payments which address farmers directly, payments to services provided collectively to agriculture (general services) and payments to support the development of rural areas in general, including for non-agricultural activities in rural areas (OECD, 2005).

## Agro-food trade policies

### *Import policy*

46. In line with its WTO commitments, China has progressively reduced import tariffs on agricultural products. Applied tariff rates are very close to the bound rates. In 2005, all tariffs applied to agricultural goods, with very few exceptions, were *ad valorem*. The fall in the applied MFN tariffs on agricultural products (WTO definition) was differentiated across various commodities but on average they fell from 23.1% in 2001 to 15.3% in 2005, which compares with an overall average rate of 9.7% in 2005 (WTO, 2006).

47. Tariff dispersion declined from a range of 0% to 121.6% in 2001, to from 0% to 65% in 2005. In particular, tariffs on cereals were reduced from 51.9% to 33.9% and on oilseeds from 32% to 11.1%. Tariffs on dairy products declined from 35.9% in 2001 to 12.1% in 2005. Nevertheless, cereals, and other traditionally highly protected agricultural commodities, such as sugar (29.9% in 2005) and tobacco (25.4% in 2005), still benefit from higher than average protection. Some of the lowest tariffs apply to oilseeds, a sector that was previously highly protected. For example, tariffs levied on soybeans fell from 114% (out-of-quota rate) in 1997 to 0-3% as of 2002. Lower tariffs apply also to subsectors in which China has a comparative advantage, such as horticultural and animal products.

48. Imports of agricultural goods are subject to VAT. The rate for agricultural products is 13%, 4 percentage points below the rate generally applied to other products. Depending on the market situation, VAT exemptions have been applied, sporadically, to a wide range of agriculture-related imports, such as seeds, breeding animals, fertilisers and pesticides, some feed components and cotton. For instance, while in principle all imports of grains are subject to VAT, if there is a domestic oversupply of cereals, the VAT exemption on grain imports is removed.

49. Tariff rate quotas (TRQs) apply to major agricultural products, such as wheat, maize, rice, soybean oil, palm oil, rape oil, sugar, wool, wool tops, cotton, and chemical fertilizers. The National Development and Reform Commission (NDRC) and Ministry of Commerce (MOFCOM) are jointly responsible for administering tariff rate quotas for rice, maize, wheat, and cotton, and MOFCOM is solely responsible for fertilisers, oils, sugar, wool, and wool tops. The size of the annual quota is based on China's commitments at the time of accession to the WTO. MOFCOM announced the elimination of the TRQ on vegetable oils from the beginning of 2006, implementing a tariff-only arrangement instead.

50. In general, imports under TRQ were differentiated and ranged from very low for rice (fill rate 11% in 2005) and maize (less than 1% in 2005) to particularly high for cotton (nearly 300% in 2005). The fill rate for cotton reached 100% by 2002. Since 2003, quota levels for cotton have been increased and actual imports substantially exceeded the original quota specified in China's Protocol of Accession to WTO (Table 4.3). According to the Chinese authorities, all cotton imports during 2002-05, including those in excess of the quota, were charged the in-quota tariff rate.

51. China's government still controls imports (and exports) of key commodities through State Trading Enterprises (STEs). Under China's WTO accession agreements, agricultural products subject to import by STEs are: cereals (maize, rice, and wheat), vegetable oils, sugar, tobacco, and cotton. STEs set import prices, which are "usually" based on the c.i.f. price plus tariff and other charges such as VAT and other taxes, port charges, inspection fees, and domestic transportation charges. China's TRQ system includes criteria for allocating the import quotas to STEs and private enterprises. STEs continue to control the majority of wheat, maize, rice and sugar imports. Their role in imports of vegetable oils (palm, rapeseed, and soybean) and cotton is much lower (Table 4.3). In addition, imports of tobacco remain under state monopoly (WTO, 2006).

**Table 4.3. Tariff quota utilisation in China, selected commodities<sup>1</sup>, 2002-05**

		2002	2003	2004	2005
Wheat	Quota level ('000 tonnes)	8 468.0	9 052.0	9 636.0	9 636.0
	In-quota imports ('000 tonnes)	632	450	7 260.0	3538
	Utilisation rate <sup>2</sup> (%)	7.5	5.0	75.3	36.7
	State-trading share	90.0	90.0	90.0	90.0
	In-quota MFN tariff rate (%)	1-10	1-10	1-10	1-10
	Out-of-quota MFN tariff rate (%)	71.0	68	65	65
Maize	Quota level ('000 tonnes)	5 850.0	6 525.0	7 200.0	7 200.0
	In-quota imports ('000 tonnes)	10	<5	<5	<5
	Utilisation rate <sup>2</sup> (%)	0.2	0.1	0.1	0.1
	State-trading share	68.0	64.0	60.0	60.0
	In-quota MFN tariff rate (%)	1-10	1-10	1-10	1-10
	Out-of-quota MFN tariff rate (%)	28-71	24-68	20-65	20-65
Rice	Quota level ('000 tonnes)	3 990.0	4 655.0	5 320.0	4 767.0
	In-quota imports ('000 tonnes)	237	260	770	522
	Utilisation rate <sup>2</sup> (%)	5.9	5.6	14.5	11.0
	State-trading share	50.0	50.0	50.0	50.0
	In-quota MFN tariff rate (%)	1-9	1-9	1-9	1-9
	Out-of-quota MFN tariff rate (%)	22-71	16-68	10-65	10-65
Soybean oil	Quota level ('000 tonnes)	2 518.0	2 818.0	3 587.1	3 587.0
	In-quota imports ('000 tonnes)	870	1 880	2 520	1 694
	Utilisation rate <sup>2</sup> (%)	34.6	66.7	80.8	47.2
	State-trading share	34.0	26.0	18.0	10.0
	In-quota MFN tariff rate (%)	9.0	9	9.0	9.0
	Out-of-quota MFN tariff rate (%)	52.4	41.6	30.7	19.9
Palm oil	Quota level ('000 tonnes)	2 400.0	2 600.0	3 168.0	3170
	In-quota imports ('000 tonnes)	1 695	2 330	2 390	4 320
	Utilisation rate <sup>2</sup> (%)	70.6	89.6	88.5	136.3
	State-trading share	..	..	..	..
	In-quota MFN tariff rate (%)	9.0	9	9.0	9.0
	Out-of-quota MFN tariff rate (%)	52.4	41.6	30.7	19.9
Rape seed oil	Quota level ('000 tonnes)	878.9	1 018.6	1 243.0	1 243.0
	In-quota imports ('000 tonnes)	78	150	350	178
	Utilisation rate <sup>2</sup> (%)	8.9	14.7	31.1	14.3
	State-trading share	34.0	26.0	18.0	10.0
	In-quota MFN tariff rate (%)	9.0	9.0	9.0	9.0
	Out-of-quota MFN tariff rate (%)	52.4	41.6	30.7	19.9
Sugar	Quota level ('000 tonnes)	1 764.0	1 852.0	1 945.0	1 945.0
	In-quota imports ('000 tonnes)	1 183	780	1,210	1390
	Utilisation rate <sup>2</sup> (%)	67.1	42.1	62.2	71.5
	State-trading share	70.0	70.0	70.0	70.0
	In-quota MFN tariff rate (%)	20.0	20.0	15.0	15.0
	Out-of-quota MFN tariff rate (%)	65.9	58.0	50.0	50.0
Cotton	Quota level ('000 tonnes)	818.5	856.3 +500	894.0 +1 000	894.0 +1 400
	In-quota imports ('000 tonnes)	177	870	1 910	2 654
	Utilisation rate <sup>2</sup> (%)	21.6	101.6	213.6	296.9
	State-trading share	33.0	33.0	33.0	33.0
	In-quota MFN tariff rate (%)	1.0	1.0	1.0	1.0
	Out-of-quota MFN tariff rate (%)	54.4	47.2	40.0	40.0

1. Other commodities covered by TRQs in China include wool, wool tops, and fertilisers (urea, NPK and diammonium phosphate).

2. Utilisation rate refers to in-quota imports divided by quota level. Quota levels for cotton were increased during 2003-05.

Source: WTO, 2006. 2005 import data from China's Customs Statistics. Utilisation rate in 2005 calculated by the OECD Secretariat.

### *Export measures*

52. China has notified to the WTO that during 2002-04 it did not subsidise its agricultural exports. Under its WTO accession agreements, China maintains the right to apply export taxes, but in 2005 such taxes were not applied with very few exceptions, such as a 20% tax on exports of raw hides and skins of goats.

53. Exporters of agricultural products are entitled to a VAT rebate at the time of exportation. Rebates vary across commodities and thus appear to have been used to manage exports of certain products, including agricultural. With few exceptions, the rebate rates are lower than the VAT rates actually paid, mainly for budgetary reasons. In general, for goods subject to a 17% VAT rate, the rebate rates are 17% or 13%; for goods subject to a 13% VAT rate the rebate rates are 11%, 8%, or 5%. The difference between the rates of VAT actually charged and the rate rebated constitutes a levy on exports (WTO, 2006).

54. State trading is used for the export of rice, maize, cotton, silk, and tobacco. Exports of soybeans were liberalised as of 1 November 2001; and the exports of tea were subject to designated trading prior to 2004. As of 1 January 2005, state trading was eliminated for silkworm cocoons and silk products. The continued use of state trading to export selected commodities allows the government to influence their domestic (and export) prices.

55. China imposes export quotas that are global (*i.e.* irrespective of destination) and destination-specific. In 2004, global export quotas applied to exports subject to state and "designated" trading such as cotton, grains, silk, and tea. As of 1 January 2005, export quotas and licensing for silk and silk products were eliminated. In 2004 and 2005, destination-specific quotas applied to, *i.a.*, live cattle, live swine and live chicken to be exported to the Special Administrative Regions (SARs) of Hong Kong and Macao. Non-automatic licences are used to manage these export quotas. Other exports, including meat products are subject to automatic licensing for statistical purposes (WTO, 2006).

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