

CRITICAL CHOICES FOR CHINA'S AGRICULTURAL POLICY

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2020 BRIEF 60

A 2020 Vision for Food, Agriculture, and the Environment

MAY 1999

Economic reforms initiated in 1978 brought rapid economic growth in China. Fundamental changes occurred in the national economic system. While the reforms were focused on agriculture, as expected, the role of the agricultural sector declined, and the manufacturing and service sectors grew much faster than the rest of the economy. Land, labor, and water shifted to nonagricultural uses. And farmers' incentives for agricultural production deteriorated. From 1990 to 1994, grain production stagnated, and in 1995 China had to import 20 million metric tons of grain. This threat to agriculture and food production alarmed the country's top leaders. New policies introduced since 1995 have succeeded in reversing declining food production, but at a huge financial cost to the government. Is this a short-term phenomenon or the beginning of a long-term commitment to protection, following the path of many developed countries? Critical choices lie ahead for China.

REFORM OF AGRICULTURAL POLICY (1978-93)

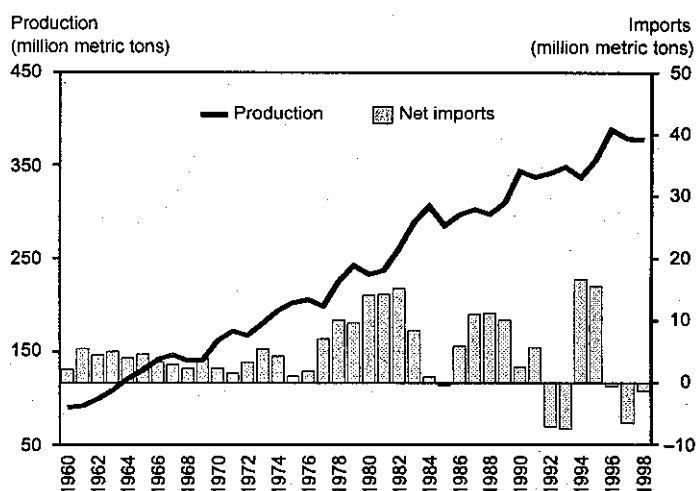
Before 1979, Chinese agricultural policy sought rural equity and the provision of cheap food, capital, and labor for industrial development. The government tightly controlled production, marketing, and trade, with procurement prices generally held below international prices. Fearing anemic agriculture would retard industry, the government began implementing new policies in 1979. Initially, the government raised agricultural procurement prices and allowed rural markets to reopen for farmers to sell produce from private plots. In 1981, the government began to decentralize agricultural production from the commune system to individual farm households. By 1984, more than 99 percent of production units had adopted the "Household Production Responsibility System." In addition, the government gradually reduced the number of commodities subject to mandatory state procurement.

The second phase of reforms aimed mainly at liberalizing pricing and marketing. On the heels of a bumper crop in 1984, the government replaced mandatory procurement with voluntary contracts between farmers and the government. In 1993, the authorities further liberalized the grain market and abolished the 40-year-old grain rationing system. More than 90 percent of all agricultural produce was sold at market-determined prices, a graphic indication of the transformation of Chinese agriculture from a command and control system to a largely free-market sector.

NEW AGRICULTURAL POLICY (1994-PRESENT)

However, as a result of pressure from high inflation, particularly from rising grain prices and declining production, leading to in-

Production and net imports of grains in China



Source: USDA and State Statistical Bureau of China.

creased imports, several new policies have been introduced since 1994. The central government boosted procurement prices above world prices, offering farmers incentives to shift production away from cotton and oilseed crops. In 1997, China harvested record grain crops: wheat imports were the smallest since 1961 and rice exports were the largest since 1973. There was another bumper crop in 1998, and stocks remain high. However, paying for these new policies has imposed a substantial financial burden on the government and hindered reforms in other sectors, resulting in a net loss in social welfare.

The "Governor's Grain Bag Responsibility System" was introduced in 1995. This holds provincial governors responsible for balancing grain supply and demand and stabilizing grain prices in their provinces. Nationally, this policy seems to have been a success, since supplies have increased and prices have dropped and stabilized. However, the record varies sharply among the provinces, particularly between richer and poorer provinces. If the policy remains, grain producers in rich coastal provinces could become more highly subsidized by local governments. In poorer surplus regions, producers could continue to be taxed. Such measures have a tendency to promote regional self-sufficiency, causing a net social welfare loss.

Another new policy initiated in 1997 is called "Four Separations and One Perfection." In response to the inefficiency of the state grain bureaus and the financial burden of government grain policy, the authorities separated (1) the bureaus' policy functions from commercial functions, (2) government-owned



reserve stocks from commercial business, (3) central government responsibilities from those of local governments, and (4) old from new bank debts. The "perfection" is a process to integrate the government procurement prices with market prices.

In 1998, the central government announced that it would further decentralize grain management responsibility to provincial governments. In fact, however, the central government has reasserted monopoly control over grain procurement. This policy helps keep prices stable, but by restraining competition, it deters improvements in the efficiency of grain marketing.

POLICY OPTIONS FOR THE FUTURE

As China approaches the stage of development in which the government shifts from taxing to subsidizing agricultural production, policymakers face a choice among competing options. The *first option* is to follow the Organisation for Economic Co-operation and Development (OECD) countries and other newly developed economies, that is, protect agriculture either through price supports or direct farm income payments. But agriculture still employs over 45 percent of China's labor, so this would be costly for industry. Moreover, as OECD countries are finding, protecting agriculture is costly in absolute terms as well. And price subsidies may not be compatible with entry into the World Trade Organization (WTO).

The *second option* is to use trade barriers to insulate China's agricultural production from the international market. In this case, domestic supply would meet domestic demand, and domestic consumers would implicitly subsidize domestic producers. Considering China's rapid economic growth and the declining share of food in consumers' budgets, this option is attractive. But because prices and markets would be distorted, overall economic efficiency would decline. The size of the loss would depend on the difference between international and domestic prices. Adoption of this option might also create a problem for China's entry into the WTO.

The *third option* is to liberalize agriculture immediately. China would neither tax nor subsidize production, explicitly or implicitly. China would import or export agricultural products based on comparative advantage. Under this scenario, it is likely that China would have to import large amounts of grain, but economic gains would be substantial. China could gain US\$4.5 to 7 billion in 2010 by abolishing its policy of 95 percent grain self-sufficiency. The World Bank has estimated that China would gain \$5 billion by 2020 if the current 95 percent grain self-sufficiency policy were abolished. However, because China is a large country, two problems could arise if it depends heavily on international grain markets. One relates to supply availability. Australia, Brazil, Canada, and the United States may have the potential to increase production. But how

much they can supply is not clear, particularly when many governments are under pressure to reduce support for agriculture. Agriculture is also subject to weather and other climatic conditions. A production shortfall of 20 to 30 percent in a major grain-exporting country would affect international prices substantially, considering the thin international market for many agricultural commodities.

The *fourth option* is to continue to liberalize gradually, while increasing investment in rural infrastructure, agricultural research and extension, and irrigation. This option would not only conform with WTO requirements but would also improve long-term food security and overall economic efficiency.

Various studies have shown that increased investment in agricultural research, extension, irrigation, and infrastructure is one of the most efficient ways to improve China's food security in the long run. IFPRI projections suggest that if China increases its investment in agricultural research and irrigation by 4.5 percent per year, it will become a net exporter of grains by 2020. With every 1 percent increase in agricultural research and irrigation investment, China could produce an additional 21 million metric tons of grain in 2010 and 36 million metric tons in 2020. Each yuan invested in research and irrigation could yield returns between 3.6 and 4.8 yuan.

However, it is worrisome to observe that China's agricultural investment, particularly its research investment, has fluctuated over time and has stagnated in recent years. After 1978, agricultural investment began to decline, bottoming out in 1987. Although it has recovered since, it was still 32 percent below the 1978 level in 1994. In relative terms, the share of agricultural investment in agricultural GDP began to decline sharply after 1978, from 18 percent to about 5 percent in recent years. Investment in agriculture as a proportion of total investment fell drastically, from 20 percent in 1980 to only 2.4 percent in 1994.

Fluctuating and falling public investments in agriculture will impede long-term sustainable agricultural growth. For example, the decline in public investment in agricultural research and development led to deterioration of the national agricultural research system and a possible slowdown in the rate of release of new agricultural technologies. Also, the decline of investments in maintenance and repair of irrigation and drainage systems, rural roads, and soil improvement schemes has reduced the effectively irrigated area and increased the impact of recurring natural disasters such as floods and drought.

Reversing the decline in agricultural investment would enhance the agricultural sector, rural well-being, food security, and the environment. All this, in turn, would foster China's broader economic development, and assure that the answer to the question, "Who will feed China?" is China.

For more information, see Shenggen Fan and Francis Tuan, "Evolution of Chinese and OECD Agricultural Policy: Long-term Lessons for China," a paper presented at the International Seminar on WTO and China's Agricultural Trade, Beijing, September 21–22, 1998; Shenggen Fan, "Public Investment in Rural China: Historical Trends and Policy Issues," in *Agricultural Policies in China* (Paris: OECD, 1997).

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