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China's WTO Accession: Conflicts with Domestic Agricultural Policies and Institutions

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This analysis examines the implications of WTO accession for China's domestic policies and institutions by identifying some of China's agricultural policies and institutional arrangements that may generate conflicts with WTO requirements and analyzing the nature and extent of the conflict. We differentiate three alternative ways that China's current domestic policy or institutions may conflict with or be incompatible with WTO accession: (1) the domestic policy or institution is expressly prohibited by WTO rules and principles; (2) the changes required by WTO accession impose additional costs on the government such that the existing policy or institutions are difficult to sustain; and (3) the changes required for WTO accession reduce the effectiveness of the policies or institutions.

Keywords: accession; China; domestic policies and institutions; WTO

Introduction

China's impending accession to the World Trade Organization (WTO) is an important event for China and for agricultural exporting nations around the world. In the broadest terms, trade policy reform under the Uruguay Round Agreement on Agriculture involves three key areas. These areas, sometimes described as the three pillars of the agreement, are market access (tariffs, tariff rate quotas, and other trade barriers), domestic support, and export subsidies. As part of its WTO accession commitment, China agreed to reduce its agricultural protection and trade barriers in all three areas, including reducing barriers to agricultural imports, expanding and creating new market opportunities for exporters, eliminating export subsidies, and capping domestic support of agriculture at current levels.

Although implementation of China's commitments is expected to impact the world economy, especially international trade flows and commodity prices, it will also have an enormous impact on China itself. As in many developing countries with large rural populations and a large share of the national economy drawn from agriculture, China's agricultural protection policies are concentrated on limiting market access. Reflecting this concentration, two critical components of China's WTO accession commitments are reduced and bound tariff rates and the introduction of a tariff-rate quota system for certain key commodities such as grains and cotton. But there are also other, less-well-publicized commitments from China to liberalize its domestic economy, the most important of which may be liberalizing its internal marketing and distribution system.

This analysis examines the implications of WTO accession for China's domestic agricultural policies and institutions. China's agricultural trade policies, especially non-tariff barriers, are part of an agricultural policy structure geared towards protecting agriculture in order to maintain self-sufficiency in agricultural supply, especially in food grain production. However, China's domestic agricultural policy environment, as well as its current system of agricultural institutions, may not be compatible with the rules and trade policy changes required by WTO accession. This study will focus on identifying some of the agricultural policies and institutional arrangements in China that may generate conflicts with WTO requirements, and will analyze the nature and extent of the conflict that may be introduced by WTO accession.

Current domestic policy or institutions may conflict with or be incompatible with WTO accession in three different ways. One type of conflict is where China's domestic policy or institution is expressly prohibited by WTO rules and principles or is expressly addressed in China's market access or domestic support commitments. Another type of conflict is where the changes required by WTO accession impose additional costs on the government such that the existing agricultural policy or institutions are difficult to sustain. And finally, a third type of conflict is where the changes required for WTO accession reduce the effectiveness, wholly or in part, of the agricultural policies or institutions.

This paper will address three of the most important changes that China agreed to make as part of its commitment package. The first two changes are in the area of market access and involve changes in China's agricultural trade policies. These changes can be categorized by the type of barrier to trade, i.e., tariff barriers and non-tariff barriers. As most non-tariff barriers are linked with China's domestic policies and its institutional system, the paper will examine non-tariff barriers most closely.

The third key area of change China agreed to make as part of its commitment package was to liberalize its domestic agricultural distribution system for major grain and oil products. China committed to allow foreign companies to have full trading rights and distribution rights, including rights in retailing, wholesaling, warehousing, and transportation. This will clearly be incompatible with China's current agricultural marketing and distribution system—a system based on a near monopoly by the government over procurement and allocation of priority agricultural commodities. Thus, the final section will examine China's WTO commitments in the area of marketing and distribution from the perspective of the government's key current policy initiatives.

Tariff Barriers to Trade

A great deal is still not known about the terms of China's accession. This analysis is based on the bilateral U.S.-China agreement signed on November 15, 1999, the only definitive information that is currently available on the terms of China's accession to the WTO. Based on the agreement, the first type of trade change that China committed to make is to reduce tariff barriers to trade. Currently, China's average agricultural import tariff rates by commodity class are 21 percent for live animals and animal products, 7 percent for grains, 17 percent for fats and oils, 29 percent for processed foods, beverages and tobacco products, and 27 percent for textiles and other processed agricultural products (see table 1 in the technical annex for selected tariff reductions in China's commitments). China's tariff cuts may not generate any direct conflict with its current agricultural policies and institutions. However, by raising the cost of imports, China's tariffs are a means of protecting or supporting less competitive domestic agricultural producers, processors, or domestic distribution enterprises. Therefore, China's tariff cuts may be incompatible with some of its domestic policy goals or programs. It is possible that, after acceding to the WTO, China will choose to assist domestic producers and distribution organizations formerly protected or supported by high import tariff duties by introducing new policies or programs—though these would have to conform to WTO rules against implementing new trade-distorting measures.

The reduction in tariff duties is expected to reduce government revenues. However, the experience of other developing countries that have reduced relatively high import tariff rates shows that in some cases an import duty reduction may actually increase tariff revenues. This occurs because the relatively high tariff rates create an incentive to bypass the collection of tariffs, either by illegally eliciting the support of customs officials to reduce the declared value of the imports, or else by evading the collection of the duties altogether (smuggling or other gray-market behaviors). Reducing the incentive to cheat by lowering the average tariff rate, therefore, could result in more goods moving through official import channels and an increase in tariff revenues.

However, even if there is a reduction in total duty revenue to the government, it is unlikely to have an important impact on domestic policy since tariff revenue, especially the revenue collected from agricultural imports, is quite small. Secondly, the government can relatively easily offset a decline in agricultural tariff revenue with an increase in other sources of revenue. Thirdly, and different from many developing countries in which tariff duties are one of the few effective means of collecting operating revenue for the central government, in China, tariff revenue is a very small component of the government's total tax revenue, and agricultural imports are a small component of total imports (see tables 2 and 3 in the technical annex). Therefore, it seems likely that if a reduction in tariff revenues occurs it will not have a noticeable impact on government agricultural policy or expenditure decisions.

Non-tariff Barriers to Trade

The second major commitment by China is to reduce non-tariff barriers to trade. Two of the most important such barriers are import quotas or licences, and the use of state trading companies. Compared to tariff barriers, non-tariff barriers are much more complex forms of intervention and are closely linked to China's agricultural policies and institutional system in general. This section will address the potential for conflict between China's current domestic policies and institutions and the proposed changes in the two major types of non-tariff barrier to agricultural trade addressed in the bilateral U.S.-China Agreement—import quotas or licences and state trading. Finally, the analysis will close with a brief discussion of one of China's more recent trade policy instrument innovations—the value-added tax (VAT). The discussion will examine how this instrument is used to manage import and export flows and what, if any, conflict this policy may have with China's accession commitments.

Import Quotas or Licences

For more than four decades China's trade in cotton and grains, especially wheat, rice, and corn, has been strictly controlled by the government and treated as a strategic activity rather than simply as buying or selling commodities. After more than two decades of economic reform, China has decentralized many economic activities, and many agricultural commodities are now relatively freely traded. However, there has been very little liberalization of grain and cotton trade.

China's import quota and licensing measures are an integral part of the system the government employs to control domestic prices, marketing, and distribution of grains and edible oils. For this reason, China's quota and licence system is different from systems operating in other countries. First, in the case of import quotas, China has never published a description of the system or the regulations or policies controlling the trade. Second, the determination and allocation of quotas are not transparent operations, either to markets or to end users of imported commodities in China.

Nominally, China's State Development and Planning Commission (SDPC) recommends a quota amount, reviewed and approved by the State Council, which the SPDC then allocates to individual provinces. In practice, however, provincial governments also play a crucial role in determining the total amount of the quota and its distribution. The amount of quota that each province obtains is determined through an unofficial negotiation process between the central and provincial governments. The process is further complicated by the fact that the total national quota amounts as well as the allocations among provinces are likely to be revisited several times during the year. Once the initial quota negotiation process between the central and provincial governments is complete, there is a similar process that occurs between provincial and local governments, whereupon the quota is finally allocated to firms holding import licences or to government-owned domestic wholesalers. In other words, quota determination and allocations are not only unannounced, they may change several times during the year depending on the outcome of negotiations between three levels of government.

After the amounts and allocations are determined, the implementation of the quota is monitored and administered by the Ministry of Foreign Trade and Economic Cooperation (MOFTEC), with the state trading companies (COFCO for grains and Chinatex for cotton) conducting the trade on behalf of the quota-holder. In most cases, quota-holders have no right to import directly from abroad, to choose their trading partners, or to specify a type or characteristic (such as the protein content of wheat) of a commodity.

A related means of managing imports is the government's import licence system. MOFTEC administers a national system of import licensing. Under current practice, in addition to a quota allocation, a firm wishing to import also has to obtain an import licence. Except for the key state trading companies such as COFCO and Chinatex, which obtain licences from MOFTEC automatically, the procedure to obtain a licence can be fraught with obstacles and hidden costs. More importantly, China currently does not allow any private companies to import or export grains, vegetable oils, or cotton.

After WTO accession, China has agreed to replace the current quota system with a transparent tariff-rate quota (TRQ) regime for wheat, rice, corn, cotton, and soybean oil imports (see table 4 in the technical annex). Imports within the TRQ quota amount will be at a low tariff, while imports above that quota amount will be at much higher duty. The TRQ quantity is scheduled to rise in equal increments until full implementation in the year 2004 (2005 for soybean oil, after which the quota is eliminated and it converts to a simple low, bound duty). The over-quota tariffs gradually decline in fixed, equal increments over the 2000–2004 implementation period (2000–2005 for soybean oil). It is important to note that the TRQ quota amount is an opportunity to import given to fulfill unmet domestic demand. It is not a commitment to import.

In addition to changing China's import quota system, the bilateral U.S.-China agreement prohibits China from using its import licensing system to inhibit agricultural trade. China will have to introduce a system whereby any company with trading rights can, according to transparent and objective rules and regulations, readily obtain an import licence to bring in major agricultural commodities. China has committed to liberalize trading rights within three years of accession. China must also allow foreign companies to apply for and obtain import licences and directly import agricultural commodities.

The final rules for this trade policy change will not be available until after the Protocol of Accession and Working Party Report are finalized and released. Nevertheless, this trade policy change will likely stimulate increased imports of major agricultural products. In particular, ready access to import licences combined with the allocation of a share of the TRQ quota to non-state trading companies will increase imports of wheat, corn, cotton, and soybean oil. Imports of other important agricultural commodities, such as meats, fruits, and sugar, will also rise as more firms are readily able to obtain import licences. However, the transition from the current system to a transparent tariff rate quota regime that allows non-state trading companies to conduct trade in wheat, rice, corn, and cotton will present a challenge to China's domestic policies and the institutions through which these policies are implemented.

Current domestic agricultural policy relies, in large part, on state control over agricultural commodity imports, especially imports of grains, cotton, and edible oilseeds and their products. The central government uses its import quota system to manage import flows, thereby isolating the influence of international markets on domestic prices and protecting domestic producers or processors. Under the new TRQ system, the government will partially lose its ability to control imports, as quotas will no longer be fully allocated to the state trading companies. Non-state trading companies and foreign companies can conduct part of the within-quota trade as well as the above-quota trade (under the high tariff rates). With the loss of the government's monopoly control over imports, the government's agricultural policies, including pricing, marketing, and distribution policies, will become much less effective.

The most immediate effect of the TRQ system would appear to be to challenge China's emphasis on food self-sufficiency. From the government's point of view, food self-sufficiency is defined as grain self-sufficiency. In the late 1990s, senior leaders indicated that in order to assure China's grain self-sufficiency, grain imports have to be limited to no more than 5 percent of national consumption levels (although some unofficial reports have claimed the target was actually between 5 and 10 percent). At current levels of consumption, the 2004 tariff rate quotas for grains would all be less than 10 percent of consumption (table 5 in the technical annex). Furthermore, with consumption growth at its current pace, and even assuming constraints on future increases in China's grain production, by 2004 the ratios of imports under the full tariff rate quota over total consumption may only be slightly above the 5 percent target.

The new TRQ quota system and open access to import licenses will also likely allow domestic prices to more closely reflect world market prices. For commodities such as grains, cotton, oilseeds and oilseed products, prices may face downward pressure as increased imports raise total supply. This could negatively impact the profit margins of state trading enterprises both at the national and provincial level. In general, China's farm prices have tended to be lower than world market prices, while the inefficient grain and other commodity distribution systems often resulted in large losses to those firms (traditionally subsidized out of the central government's budget) and a large marketing margin for the state trading enterprises. With increased competition from imported goods and from non-state-owned or foreign companies, the pressure on the current state trading enterprises will in turn affect the implementation of government agricultural policies.

It is important to remember that introducing competition into China's agricultural economy will not necessarily hurt Chinese farmers or the food processing industry. Instead, as there are significant differences in the economic development across regions in China, allowing different regions to concentrate on different agricultural commodities in which they have a comparative advantage in production and trade, grain imports and foreign competition could benefit some Chinese farmers. Of course, to realize this benefit, China's government has to re-think and further reform its current agricultural policy and institutional regime towards better use and allocation of inputs such as land, labour, and capital.

Significant questions remain about how China will implement the new TRQ quota system. For instance, how will the quota be allocated to private traders? Will it be distributed through an auction, or on a first-come, first-served basis, or through some other means? These questions and others are still being addressed in the multilateral negotiations in Geneva, and answers must wait until their conclusion. Recent press reports indicate that China has already committed to use a one-tier method of allocation. A one-tier method of open auction, or even a first-come, first-served system, would be less distorting to the economy than a multi-tier system of allocation and would likely be more welcomed by foreign exporters. A multi-tier quota distribution system would be less transparent and more difficult to monitor. Although the details of the new TRQ system will not be completely available until China creates it, it is clear that to implement its commitments China will have to either sharply reform its current domestic agricultural policy and institutions or find other new policies that are WTO-compliant to replace them.

State Trading

State trading and the quota and licence system are two different sides of one problem under the current system. While the state trading enterprises allow the government to effectively control imports under the quota system, the current quota and licence system, on the other hand, effectively protects these state trading enterprises and allows them to survive. Another important characteristic of China's new TRQ system is that a predetermined share of the within-quota imports is reserved for private import companies. The share is fixed for some commodities but rises in equal increments for other commodities over the implementation period (table 4 of the technical annex). Any portion of the within-quota quantity reserved for state trading companies that is unused after three quarters is reallocated to private import companies. These features are geared towards creating competition among importers in China, as well as providing incentives for state trading companies to fully meet domestic demand and be more responsive to the needs of end users.

Although China's state trading companies are currently only agents acting on the behalf of quota holders, they act as another layer of government control over grain and cotton imports. As trading agents, state trading companies behave more or less like profit-seeking enterprises. However, in their role as instruments of the government to control trade, these companies have to follow the instructions of the government in conducting trade—in some cases importing or exporting at a time when prices cannot maximize companies' profits and may even force companies to lose money.

On the other hand, their privileged knowledge of China's import quotas and their monopolist position in conducting trade often allows state trading companies to extract outsize profits from their trading operations. Their multi-function position provides them with information that can be used to their benefit. However, once the new system eliminates the monopoly of state trading companies over agricultural commodity imports, the introduction of private trade companies, including foreign-owned trade companies, will make it difficult for the state trading companies to play their multi-function roles. In contrast to the current practice, end users will have more control over the quality and other characteristics of the agricultural product they import.

In terms of the impact on China's domestic agricultural policy, the elimination of the state trading company monopoly over China's grain and cotton imports is essentially identical to the impact of the new TRQ system. In addition, it will put pressure on the profit margins of state trading enterprises as barriers to the entry of private competitors fall. From the perspective of domestic agricultural policy, this trade policy change will likely not have a direct impact. It will have an indirect impact similar to the impact described for the TRQ quota system—increased imports and reduced effectiveness of domestic support as domestic prices fall. However, elimination of the state trading monopoly could provide benefits to processors to the extent that more competition between domestic output and imported commodities increases buying options and potentially drives down the prices of their inputs, and therefore their cost of production.

Value-added Tax

Beginning in the mid-1990s, China introduced a value-added tax (VAT) system to provide another means of increasing government tax receipts. By the late 1990s, however, the system was also being used as an important policy instrument to support exports or to discourage imports. Unlike the VAT applied by many other countries, the VAT system in China is quite flexible and the rates of VAT are often subject to change as the government attempts to manage trade flows.

The government can raise, reduce, or exempt a value-added tax rate for a specific commodity, for goods produced by a specific province or a specific company, or even for goods used for a specific purpose. For example, a commodity produced for export can have a low rate of VAT, a rebate, or even a tax exemption, while the same commodity bound for the domestic market faces a high VAT rate. An imported good may be charged a VAT in one year but charged little in another year. The commodities produced by a state-owned company may be exempt from the VAT, while the same commodities produced by non-state company are subject to the VAT.

Although the U.S.-China bilateral agreement does not contain language specifically addressing China's value-added tax (VAT) system, China's use of the tax to discriminate against some products (for instance, those destined for the domestic market rather than for the export market) would almost certainly run counter to the "non-discrimination" language found in GATT Article 3. Therefore, if China uses the VAT system to create a "non-level playing field" for different producers or different products, or to discriminate based on the ultimate destination of a product (foreign or domestic), then China's VAT system would appear to be in direct conflict with prevailing WTO rules. However, if the VAT system is applied to producers and products in a non-discriminatory manner, taxing all substantially alike products at an equivalent rate, then the system would not conflict with WTO rules.

Domestic Marketing and Distribution

China has committed to phase in, over a three-year period, liberalization of the right to own and operate agricultural distribution services for all commodities except tobacco and salt. The liberalization applies to the services of wholesaling, retailing, commission agents, and franchising, and their related subordinate services. It also opens up sectors related to distribution services such as repair and maintenance, warehousing, and trucking services. At present, China restricts the right to own and operate distribution services for many agricultural commodities (grain, cotton, and edible oil, for instance) to a few, select, state institutions.

The government generally prohibits foreign firms from distributing products other than those they produce in China and from controlling their own distribution networks. Furthermore, China also prohibits domestic enterprises from operating distribution and warehousing operations and providing marketing or other services for certain agricultural commodities, most notably grains and cotton. Instead, purchasing, processing, distribution, and warehousing of wheat, rice, corn, and cotton are restricted to state-run agencies—China's Grain Bureau (operating at provincial and county levels, including affiliated Grain Companies) and the All-China Federation of Supply and Marketing Cooperatives (and affiliated Cotton and Jute Companies).

Although the final language on China's liberalization of distribution services will not be available until the multilateral negotiations are complete, and the language included in the provisions of Annex 1 of the U.S.-China bilateral agreement does not explicitly include (or exclude) direct purchases from farmers or procurement, it appears that this could be considered a "related subordinated service". If this interpretation is correct, and there is no language in the final Accession Protocol that excludes this service, then this liberalization will have a dramatic effect on China's domestic grain and cotton procurement and marketing policies.

China's grain and cotton procurement agencies would no longer have a monopoly on procurement, but would have to compete with private (including foreign-owned) enterprises to procure from farmers. Over time, as private enterprises enter, this could sharply reduce the government's ability to intervene in the grain and cotton markets through administrative mandates to the state procurement agencies.

Currently, China's official policy prohibits any entity but an authorized grain or cotton company (and a few, authorized, large end users such as feed mills or yarn mills) to purchase directly from farmers. All other grain or cotton users have to purchase from the state grain companies at local or wholesale markets or from cotton companies (or from the state at the recently inaugurated China National Cotton Exchange). In practice, however, there are growing numbers of black-market private dealers scouring the countryside purchasing grain and cotton at prices above the prices paid by the official state buying agencies. So to some extent, and assuming the government does not initiate a crackdown, the current policy is already weakening. This weakening of the strict government procurement monopoly may mitigate the impact of the commitment to liberalize the government marketing and distribution system.

Besides trade policy, China's government agricultural policy can generally be categorized into four broad areas—production policy, marketing policy, price policy, and finally, a stock or food security policy (see the technical annex for detailed discussion of these policies). The liberalization of the government grain and cotton marketing and distribution system will affect all four of these policy areas, though in different ways and to different degrees.

In many other areas, China's agricultural policies do not appear to conflict with the domestic support rules and commitments required by the WTO Agreement on Agriculture (AoA). The AoA states that "Green Box" policies are exempt from reduction commitments, so long as they are minimally trade distorting, provide support through a publicly funded government program, do not have the effect of providing price support to producers, and do not involve direct linkages between program payments and output. In China's case, there are many different government programs that meet these criteria, including:

- agricultural research programs at the various national, provincial, and local agricultural institutes, particularly in the areas of plant breeding, insect control, and technology;
- plant and animal disease and pest control programs operated by China's Ministry of Agriculture and other agencies within the national and sub-national government;
- agricultural extension services provided to all farmers through the Ministry of Agriculture's extension office network;
- domestic food aid provided to selected poor counties designated by the central government;
- a related but separate program of regional rural development to reduce poverty by building up infrastructure (electricity, roads, bridges, markets, schools, etc.) and funding small-scale economic development projects such as establishing pasture land, reforesting, or building small-scale reservoirs;
- rural disaster relief programs for farmers and rural residents suffering loss of crops or livestock due to floods, drought, or other natural disasters.

These and other similar policies, while supporting agriculture, are generally considered to be minimally trade distorting, and as such will likely be considered exempt from any reduction commitment. In fact, so long as these policies strictly conform to the "Green Box" standards of WTO rules, there is no explicit limit to the value of the government's support of these policies.

Conclusion

On balance, and based only on the incomplete information currently available on China's WTO commitments, there will be a number of important domestic agricultural policy programs or goals that will conflict with either WTO rules or with China's bilateral commitments. The greatest conflicts centre on China's policies that manage agricultural supply, distribution, and trade of major commodities.

First and foremost, China's state trading enterprises will no longer have a monopoly on trade in wheat, rice, corn, cotton, and soybean oil. Private traders will be able to compete with state trading companies. This is likely to reduce the government's ability to use state trading enterprises as policy instruments to limit imports in order to support domestic production. However, if domestic demand surpasses available domestic supply, including the full TRQ import quantity, China can unilaterally increase the quota amount to moderate the impact of rising domestic prices on consumers. Despite the apparent loss of control over imports predicated by the introduction of the TRQ system, the quotas established in the U.S.-China bilateral agreement are roughly in line with the government's policy goal of limiting imports of key agricultural commodities to 5 percent of consumption.

The second most important conflict with China's WTO commitment is likely to be China's use of a state-run monopoly procurement system for grains and cotton. Although the text in the U.S-China bilateral agreement is not definitive, it appears that this monopoly may be gradually reduced and eventually eliminated. The government may be required to allow private domestic and foreign firms or even farmers'own cooperatives to purchase directly from producers, and then operate wholesale distribution, warehouse, and retail operations. This change will sharply diminish the government's ability to meet its current policy goal of managing supply and distribution of key agricultural commodities. The impact on farmers, however, is likely to be mixed; whether they tend to benefit or to suffer losses relative to the old system will be influenced by general agricultural supply and demand conditions. The issue for the government, however, will be to find alternative, WTO-compliant policies to meet its stated goals of stabilizing and managing agricultural markets and prices, raising farm incomes, insuring supply and reasonable prices for consumers or end users, and, finally, maintaining social and political stability.

On the other hand, the change in China's import tariff duties is not expected to have a significant impact on either domestic policy or on government revenues. Revenue may not even be reduced. But if revenue does fall, tariff revenue as a share of total government revenue is already on a declining trend and, on average, only accounts for around 5 percent of total revenue.

In terms of domestic support, China will face a conflict in the operation of its grain stockholding policy. This policy will not be as effective, and could become increasingly costly as well, if it is maintained but modified to comply with WTO rules. A WTO-compliant grain stockholding policy would be less effective at managing and stabilizing the grain market, but would probably still have some efficacy in terms of implementing stock policy. The final design of the WTO-compliant system and the amount of financial resources that the government is willing to commit will be the determining factors in whether the new system can fulfill the government's current policy goals.

Finally, the large number of government programs that meet the WTO "Green Box" criteria will be increasingly important to China's agriculture. If direct support of agriculture is capped and in some cases reduced, China will need to increase alternative types of support for farmers, including providing increased levels of resources for technical improvements in crop varieties and livestock breeds, rural infrastructure projects, timely market information, and rural development programs aimed at alleviating poverty. In this way, China's farmers will, it is hoped, be able to reduce costs, increase yields, and improve their competitiveness.

In sum, China's accession to the WTO is likely to provide some serious challenges to policy makers as they struggle with the conflicts between their WTO commitments and their domestic agricultural policies and institutions. China's leaders will need to move beyond their traditional set of policy options and look for new, creative ways of insuring sufficient farm income, providing consumers with ample, high-quality food products, and providing the vast Chinese countryside with better economic opportunities and hence more efficient allocation of resources along the lines of their own comparative advantage. The changes that China will need to make in terms of altering domestic institutions or adjusting domestic policy will be very difficult. Nevertheless, in the late 1970s China was successful in transforming its struggling collectivized agricultural system into its current socialist-market system. This dramatic transformation was a success by almost any measure—and one that provides some optimism for this next transition.

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The technical annex to this paper, pages 204-210, is available as a separate document.