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Technical Annex

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

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Discussion of China's Agricultural Policies

Production Policy

China's current agricultural production policy revolves around administrative guidance of farm production decisions. The central government sets grain- or cotton-sown area targets which are transmitted down through the government hierarchy to village leaders and ultimately the farmer. Local officials and party chiefs continue to have a great deal of influence over farmer planting decisions, primarily because local officials control access to education, authorizations to have children, and many other important facets of daily life. In addition, offices of local officials are the points at which agricultural taxes and many other types of fees are collected. Farmers know from experience that disregarding instructions from local officials on agricultural matters may bring hardships to other areas of their lives.

The entrance of private procurement agents will not directly impact the government's production policy because the government's principal instrument for effecting production policy is the local official. Nevertheless, the entrance of private procurement and distribution enterprises would clearly diminish the effectiveness of the government's production policy. Local officials could respond by increasing pressure on farmers, but given current farmer discontent and several recent instances of rural unrest, this would be a very risky policy and could spark even more problems.

Price Policy

The government's use of the procurement agency monopoly for purchases from farmers provides a centrally controlled mechanism to implement the government's protection (or minimum floor price) for grains. Although provincial governments are involved in setting these protection prices, the central government continues to influence the final price levels. The protection price was established in the late 1990s in order to provide a measure of security for grain farmers during periods of low prices. The policy was enacted during a high inflation period and was not invoked for several years. Today, in an environment of low market prices for grain, the government has tried to use the monopoly power of its grain procurement agencies to protect farmers' incomes. At the same time, it did not want to increase spending to cover the costs due to the price gap between protection prices and market prices. The government hoped to provide a boost to market prices by limiting grain procurements to its grain-purchasing stations. However, market prices were not pushed up by this policy initiative. Grain-purchasing stations were not enthusiastic about buying additional grain without sufficient government funding to cover their storage costs (since the national grain surplus created an environment of low sales prices and limited demand). Thus, there have been numerous reports of grain-purchasing stations circumventing the government's protection price policy. In some areas this occurs by downgrading the quality of the farmer's grain, while in others, the grain station simply refuses to purchase all the grain the farmer wishes to sell at the protection price.

Grain bureau companies, as monopoly purchasers, are the government's vehicle to control (at least partially) the prices farmers receive for their grain. With the emergence of private grain (and cotton) marketing enterprises, it is hard to imagine how the government will be able to utilize its current institutions and effectively maintain the current price policy. While the government might attempt to require private procurement enterprise to pay a minimum price for purchases from farmers, compliance would be extremely difficult to monitor and enforce.

Stock or Food Security Policy

The government also uses its monopoly over grain purchasing and distribution to ensure that it has sufficient quantities of strategic grain reserves. Some of the grain purchased by the grain bureau system is earmarked for strategic stocks. Although it is not commonly known, government grain stocks have traditionally been purchased at prices below market prices (though more recently the situation is different—government fixed and protection prices are higher than free market prices) because of the monopoly over grain purchasing. In addition, the government can ensure it meets a grain reserve target because it can simply order grain companies to deliver grain to a reserve warehouse (or declare the grain purchased by the grain company as reserve grain and then pay the company a subsidy for storage costs).

Once the marketing and distribution system is liberalized, the government will still be able to use the government purchasing stations to procure grain for strategic reserves. However, the government will be competing with private marketing enterprises for procurements, so its ability to purchase grain at a discount to the free market price will be limited, particularly in more developed regions of the country, where competition with private marketers is likely to be fiercest. The government may be required to pay higher prices to procure grain for strategic reserves under this new system, raising government expenditures. This in turn might lead to a reassessment of the wisdom of carrying large amounts of strategic and commercial grain reserves. Furthermore, although the government would still have the ability to mandate transfers from state grain companies into state reserves, the quantity purchased by the grain companies will be reduced by the amount purchased by private companies. In time, the government could face a situation where there is insufficient grain purchased by the state grain companies to meet its reserve targets.

Marketing Policy

Although allocation and distribution have already been liberalized to some degree over the last decade, the government is still the dominant actor in this arena. The government periodically initiates crackdowns on illegal merchants in order to shore up that dominance.

Following accession to the WTO, the entrance of private marketing and distribution enterprises will weaken the government's ability to guide allocation of grains and cotton to favored processing enterprises, which are generally large, state-owned firms. The immediate result of the weakening of government control would be more choices for end users as to their supplier, higher acquisition costs for the state procurement agencies as they compete for the commodity, and lower margins for the state agencies as they lose market share. Government expenditures supporting these agencies would rise at the same time, as the effectiveness of the market management policy would diminish.

Domestic Support

Another important part of China's WTO accession package is its commitment to cap domestic support for agriculture. Also, all of China's future government expenditures in support of agriculture must conform to WTO rules with regard to so-called "Green Box" and "Amber Box" policies.

China's domestic support commitments are still under negotiation. However, based on accession commitments from other countries that have acceded to the WTO, some likely commitments include a cessation of export subsidies, a commitment to cap domestic support to agricultural producers, and a commitment to refrain from using clearly trade-distorting domestic policies (for instance, linkages between government payments and production). In addition, China's government programs, policies, laws, regulations, payments, financial flows, and other activities that affect agriculture will have to be much more transparent than they are currently.

The compatibility of China's domestic support commitments with current domestic policy is difficult to gauge without referring to domestic support tables and China's base aggregate measure of support (AMS) notification. China's AMS notification forms the basis for capping and then reducing future product-specific and non-product-specific support payments by the government, including the use (or non-use) of the *de minimis* provision.

In general, the need to cap support to agriculture would obviously have an impact on many of the programs China uses to support grain and cotton producers. In particular, China would not be able to pay farmers prices higher than world prices if doing so raised the aggregate total AMS above the cap.

The public stockholding of agricultural commodities for food security purposes will certainly fall into China's domestic support commitment. Assuming that China claims this as a "Green Box" policy—which is allowed under the Agreement on Agriculture—China will have to make significant changes in the program as it exists today. Annex 2 of the Agreement on Agriculture states that:

> The volume and accumulation of such stocks shall correspond to predetermined targets related solely to food security. The process of stock accumulation and disposal shall be financially transparent. Food purchases by the government shall be made at current market prices and sales from food security stocks shall be made at no less than the current domestic market price for the product and quality in question. (*Agreement on Agriculture,* Annex 2, paragraph 3)

Therefore, under general WTO rules, China will no longer be able to keep stock information secret from the world community by claiming it is a "state secret". It will also no longer be able to use administrative prices to purchase grain for the stock program (during periods where administrative prices are higher than world market prices). China also will not be able to sell stocks at prices below current domestic market prices. And finally, these restrictions on purchases and sales of government stocks will apply to provincial grain stocks as well as to central government grain stocks.

Assuming that China chooses to maintain its public stockholding policy and abide by the conditions identified in Annex 2, there will clearly be an impact on both the cost and effectiveness of the current policy. China will not be able to directly support agricultural producers by paying above-market prices for grain going into state reserves. However, during a period of downward pressure on domestic prices, it will still be able to announce and implement a government grain-purchasing program at the current market price. By entering the market, it will increase demand for the commodity and thereby provide price support. The downside to this option, of course, is that farmers will be less likely to reduce area the next year because of the government's intervention and support of the market. The government could end up burdened with growing quantities of grain stocks, and ultimately reach a point where a large area adjustment is necessary in order to bring production back in line with demand. In other words, government intervention for stock-building purposes, while supporting the price in the short term, could lead to a more dramatic fall in prices in the long term as well as rapid growth in government expenditures.

Table 1 Selected Tariff Cuts in China's Commitments

Item	Base (%)	2004 (%)
Beef	45	12
Pork	20	12
Poultry	20	10
Citrus	40	12
Grapes	40	13
Apples	30	10
Almonds	30	10
Wine	65	20
Cheese	50	12
Ice cream	45	19

Source: *U.S.-China Bilateral Agricultural Agreement,* 1999

Table 2 China's Government Tax Revenue

	Total (billion RMB)	Tariffs (billion RMB)	Share (%)
1990	282.2	15.9	5.63
1991	299.0	18.7	6.26
1992	329.7	21.3	6.45
1993	425.5	25.6	6.03
1994	512.7	27.3	5.32
1995	603.8	29.2	4.83
1996	691.0	30.2	4.37
1997	823.4	31.9	3.88
1998	926.3	31.3	3.38
1999	1068.3	56.2	5.26

Source: *China 2000 Statistical Yearbook*, p. 258

Table 3 Agricultural Imports as a Share of China's Total Imports

	Total imports (billion $US)	Agricultural imports (billion $US)	Agricultural share of of total imports (%)	Total tariff revenue over total imports (%)
1990	53.3	4.5	8.39	6.23
1991	63.8	3.7	5.83	5.51
1992	80.6	3.9	4.85	4.79
1993	104.0	3.0	2.83	4.27
1994	115.6	5.0	4.34	2.74
1995	132.1	9.1	6.91	2.65
1996	138.8	7.9	5.67	2.62
1997	142.2	6.3	4.43	2.70
1998	140.2	5.5	3.89	2.70
1999	165.7	5.2	3.13	4.10

Source: *China 2000 Statistical Yearbook,* p. 590

Table 4 China's TRQ System Quotas, Tariff Rates, and Private Trade Share

	Quota amount		**In-quota tariff**	**Over-quota tariff**		**Private share**	
	2000	**2004**		**2000**	**2004***	**2000**	**2004***
	million tons		**(%)**	**(%)**		**(%)**	
Wheat	7.30	9.64	1	77	65	10	10
Indica rice	1.33	2.66	1	77	65	10	10
Japonica rice	1.33	2.66	1	77	65	50	50
Corn	4.50	7.20	1	77	65	25	40
Cotton	0.74	0.89	4	69	40	67	67
Soy oil **	1.72	3.26	9	74	9	50	100

* 2004 is the final year of implementation for every commodity *except* soy oil (see below).

** The final year of implementation for soy oil is 2005 (the tariff-rate quota reaches 3.26 million tons); for 2006 the TRQ is eliminated, converting to 100 percent private trade with a tariff rate of 9 percent.

Source: *U.S.-China Bilateral Agricultural Agreement,* 1999

Table 5 China's Projected Grain Self-sufficiency Ratio

	1999/00 consumption (million tons)	2004 TRQ (million tons)	TRQ share of consumption (%)
Wheat	117	9.64	8.2
Rice	137	5.32	3.9
Corn	117	7.20	6.2

Source: *U.S.-China Bilateral Agricultural Agreement* (1999) and USDAPS&D database