



## WTO and agriculture: radical reforms or the continuation of gradual transition

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Although agriculture has been at the center of China's negotiations over its entry into the World Trade Organization (WTO), the agricultural agreement and its implications for farm producers are not well-understood. In its most basic terms, the agreement lowers tariffs, increases access to China's markets by foreign producers of some commodities through tariff rate quotas (TRQs), and completely removes quantitative restrictions on others. In return, China gets better access to foreign markets for its agricultural products, as well as a number of less obvious benefits. China, however, is *not* required to eliminate either state trading or many of its distortionary domestic policies. In part because changes affect some commodities more than other ones, the agreement has been characterized as radical by some, but inconsequential by others.

In response to the uncertainty over what WTO holds for agriculture, our essay proposes to attempt to clarify the nature of the agreement as it permits to agriculture and to assess its effect on China's farm sector. To do so, we first provide our interpretation of how much the current settlement represents a break with the past. We then explain why we do not believe the predictions that China's agricultural sector will be greatly harmed. In addition to the obvious direct benefits to the rural population from rising employment in sectors that use rural migrants, market imperfections, domestic policy responses, and newly arising export opportunities will buffer the adverse effects. While space limitations dictate the most cursory look at many issues, much of what is presented in this essay is covered in more depth in a paper posted on our websites.<sup>1</sup>

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<sup>1</sup> See the paper "Trade Liberalization and China's Food Economy in the 21st Century: Implications to China's National Food" by Jikun Huang, Chunlai Chen, Scott Rozelle, and Francis Tuan at [www.ccap.org.cn](http://www.ccap.org.cn) and [www.ucdavis.agecon.edu](http://www.ucdavis.agecon.edu).

## **1. A continuation of 30 years of reform**

One of the most significant features of China's open door policy and the shifting trade regimes is the remarkable expansion of China's international trade, although performance of agriculture has been mixed. China greatly improved its position and increased its share in the world trade, moving from 26th place in 1980 to the 10th largest trading nation in the world in 1997. The share of agricultural trade, however, fell from 21% in 1980–1984 to 9% in 1995–1997. Despite the declining share, agricultural trade volume increased during the same period at an annual growth rate of 6%, making China's agriculture more open. The ratio of agricultural trade to agricultural GDP increased from 10% in 1980 to 15% in 1997. The growth of exports outpaced that of imports, a reflection that China has been following a strategy of moving from import substitution to more export promotion.

Changes in trade and other policies have also affected the composition of China's trade. Disaggregating by crops indicates a changing composition of trade, and suggests an export trend toward products in which China has a comparative advantage. The net exports of land-intensive bulk commodities, such as grains and oilseeds, have fallen, while exports of higher-valued, more labor-intensive products, such as horticultural and animal (including aquaculture) products, have risen. The proportion of grain exports, which was only around 20% of total agricultural exports in the 1990s, is less than half of what it was in the early 1980s; by 1997, horticultural products and animal and aquatic products accounted for around 80% of agricultural exports. These trends are even more evident when reorganizing the trade data, grouping them on the basis of factor intensity.

Taken as a whole, we believe the trends of China's agricultural trade over the past two decades reveal that the changes that are expected to be experienced as a result of WTO are not new. Changes in the level and patterns of agricultural trade suggest that China was already moving towards a point that was more consistent with its domestic resource endowments. To the extent that the new trade agreements reduce barriers to allow more land-intensive products into the domestic market, and the fall in restrictions overseas stimulates the export of labor-intensive crops, WTO's main impact will be to push forward trends that were already happening on their own. In short, we believe the nature of the changes in agriculture that will be caused by WTO is more of a continuation of past trends rather than a radical policy change.

## **2. WTO impacts: large, modest, or none**

Continuation of old trends, however, does not automatically mean that the impending changes will be insignificant. Even if the nature of the changes is not new, it is still possible that the pace of change will be accelerated so greatly that the implementation of WTO could have substantial negative welfare impacts. Is it possible that the competition from foreign agricultural commodities will be so high that farmers will be seriously harmed? Should policy makers worry about dislocation costs being so high among certain groups of producers that they should be concerned about maintaining a healthy and stable agricultural sector? Those who subscribe to the idea that WTO is going to have large negative impacts on China's

farming sector predict that the post-WTO fall in prices and intrusion of foreign agricultural commodities will lead to a sharp structural change in the nation's cropping patterns. Concerns have also been voiced that the poor will suffer significant income falls.

While we do not want to suggest that China's accession to WTO will not have a significant effect on agriculture (it will), we do believe that there are at least five reasons to believe that the net negative impact will be substantially less in both the short and the long run. First, and most obvious, while the rural population may lose in net terms as agricultural producers due to the net price falls in key commodities, it will gain as consumers of these same agricultural products. Also, rural workers gain if they are able to find more employment opportunities in sectors that thrive as a result of lower restrictions for China's export goods.

Beyond these more familiar general equilibrium effects, the nature of China's rural economy will insulate many producers from striking changes. In rural economies similar to those found in China, economies in which markets are still underdeveloped and buyers and sellers face high transaction costs, producers in the backward regions should not be expected to be greatly influenced by changes in the border price of farm commodities. In fact, according to theoretical and empirical findings of economists such as Singh, Squire and Strauss (1986), it is actually possible to have income effects and the effects of changes in the shadow values of land and labor that induce agricultural households to increase output when market prices fall. Models that do not account for the semisubsistence nature of households tend to overestimate the price responsiveness of households. For example, the experience of Mexican agriculture's response to the North American Free Trade Agreement (NAFTA) suggests that only the commercialized part of the agricultural sector was heavily affected by trade liberalization and that the overall impact of output and rural incomes has been fairly modest. In 2000, nearly 90% of the maize farmers in Mexico are still producing their crops in the same ways and in the same quantities as they had been doing before NAFTA. In contrast to the predictions of some economists, Mexican farmers did not abandon their land and turn into landless migrants. In this same way, it is likely that most semisubsistent farm households in China's remote interior — the areas about which policy makers in China worry the most when discussing China's WTO accession — will be similarly insulated.

Other forces also exist that will help guard against the most severe long-run effects. Even in an economy dominated by small farmers, it is always possible that there could be a fairly large, short-run impact; prices could fall further and domestic output and incomes could decline more than expected. If so, however, it does not mean that China's agriculture will wither. The continued ideological commitment of China's leadership to self-sufficiency (whether warranted or not) would almost assuredly elicit a sharp policy response, a response that could either be in the spirit of trade liberalization or not. For example, in the same way that China's top leaders increased spending on water control and agricultural R&D in the 1990s when they perceived macroeconomic imbalances threatened the nation's food security, higher investments could make China's farmers more competitive in a post-WTO world. Infrastructure investments are not only WTO-consistent, they are encouraged as "green-box" measures. Alternatively, if the investment programs were not successful, or if their effects were perceived to be too slow, there are other actions that China's government could take, which, under the existing agreement, would be legal. Under the current agreement, when imports exceed the nation's TRQ commitment, China can still legally raise tariffs up to a

predetermined binding rate, which currently averages about 60% for most major farm commodities. As a last resort, leaders almost certainly could use state trading, which is still allowed under the current round's WTO agreement, to manage trade flows.

More fundamentally, it is often easy to overlook the fact that China's accession to WTO affects protectionist policies not only at home but also in countries to which China is currently exporting and potentially could export even more. Undoubtedly, wheat, maize, and soybean producers are the most vulnerable to changes that will follow China's entry into WTO. In a post-WTO world, however, China's horticultural and livestock producers could find themselves with greater markets opportunities and become more profitable and more competitive on international markets. Especially if WTO helps breaks down international and domestic barriers to investment and to improved infrastructure, it is likely that the quality of China's fruits and vegetables and processed food products will improve and will be able to compete in any world market. As trade barriers fall elsewhere in the world, it is not inconceivable that China could dominate, or at least heavily participate, in the world's markets for walnuts, apples, citrus, strawberries, grapes, asparagus, processed tomatoes, and many other crops.

Finally, in a post-WTO environment, farmers could benefit from access to more and cheaper imported technologies. Currently, imports of pesticides and herbicides are restricted, and foreign direct investment opportunities in the agricultural input sector are limited by inadequate intellectual property rights, lack of regulation, and antiquated distribution systems. In a China dominated by firms that must be internationally and domestically competitive, there will be great pressure to welcome Deere and Co., Pioneer and Monsanto (among others). Today's policies in China are curiously protecting industries, like seeds and pesticides, that have very little future in world markets. WTO will not only subject China's farmers to greater competition on the output side, it can increase their competitiveness around the world by increasing access to the world's input markets.

### **3. Concluding thoughts**

So, what is our conclusion? Have we met our first goal of characterizing the reforms that will occur as a result of the WTO agreements? We think we have. We have shown that over the past two decades, China has made gradual progress in reforming and liberalizing its agricultural economy, both inside and outside of the nation. While at first glance China's accession to WTO seems to represent a great leap forward in liberalization, it is clear that there are still many barriers that stand between the current situation and a significantly freer trade regime. Pessimism aside, however, maybe the best way to characterize the WTO agreement is that it is not a radical departure from the past, but is most aptly described as yet another step — yes, a significant one — on China's road to a more market-oriented agricultural sector. But even though it is not new and it will not lead to complete liberalization, China's accession to WTO will hold many new challenges and opportunities for reformers, producers, and consumers.

Will farmers lose or gain from China's accession to the WTO? Our paper would have met its second goal if we had provided an unequivocal answer to this question. Unfortunately, we are the first to admit that our essay has done little to provide a definitive estimate of the

aggregate impact of WTO on China's agriculture. If anything, we introduced more uncertainty. One of our main contributions is to have demonstrated that understanding future benefits and costs hinge not only on the fact that China produces many products in many regions of the nation that will be in competition with the rest of the world. In addition, there is a whole set of more fundamental factors that will ultimately determine how well China's farmers will fare in the post-WTO world: farmer decision-making in an environment of imperfect markets; the policy and investment response of the leadership; and the ability of China's farmers to enter overseas markets and to access to new sources of investment and imported technology. In the long run, the final accounting of WTO's impact on Chinese agriculture will depend on how leaders, producers, and consumers respond to the new opportunities offered by WTO and how they deal with the new challenges.

## **References**

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