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Issues and Challenges in Agricultural Reform

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There have always been three challenges facing China's agriculture: to raise food supply with a low per capita land endowment; to create employment opportunities and raise farm incomes; and to improve rural infrastructure for sustained development.

Before the rural reforms beginning in the late 1970s, China's development strategy focused on how to raise productivity through collectivisation. It was thought that the commune system would not only provide full employment in rural areas but also increase incentives for farmers to work. This would ensure rapid growth of farm incomes. It was also believed that the commune system would be in a better position to exploit scale economies by enlarging farm size and building rural infrastructure. However, the commune system proved to be a failure. Not only did it fail to provide work incentives to farmers and hence resulted in low productivity and income growth, but it also created inefficiency in the use of rural infrastructure (Lin 1992). Although everyone had a job, marginal productivity was so low that there was actually large underemployment.

The household production responsibility system introduced in the late 1970s proved to be a much more effective institution in stimulating farm incentives and mobilising rural resources (MacMillan *et al.* 1989). Farm output increased dramatically between 1978 and 1984. Since 1985, the growth of the grain sector has slowed, but the overall rural economy has kept growing at an impressive rate. While farm incomes increased, underemployment was brought to the surface. Farmers now actively seek employment opportunities both in rural and urban areas.

There have also been extensive reforms in land tenure. In the early 1980s, farmers were given the right to use the farmland allotted to

them for fifteen years. This provided much needed certainty for land use. Over time, compulsory state procurement of farm commodities has been loosened, although not completely abolished. Free markets were legalised and eventually encouraged. These reforms laid the foundation for the rapid growth of the rural economy over the past two decades.

The reform of China's rural economy is far from complete. Much reform has been delayed, partly because of complacency due to the initial success in rural reform and partly because of the slow pace of urban reform. The need for further reform has become increasingly apparent. The recent debate on whether China can feed itself has only highlighted the concern over the long-term development of China's agriculture and the urgency of further reform.

The problems and the environment for further reform

A number of problems have emerged in recent years. First, the household production responsibility system needs improvement. This is essentially an issue of land tenure. Despite the official 30-year extension to land tenure from the early 1990s (the starting years vary as the initial land contracts in the early 1980s were introduced at different times for different regions), farmers are concerned about the long-term stability of land tenure. This partly results from the fear of a repeat of the collectivisation policy of the 1950s and partly because of the delays in announcing the new land tenure system. It was not until 1998 when the 30-year lease policy was formally announced. In addition, the 30-year lease is not really long enough to address farmers' concerns. As a result, long-term farm investment has been weak, punishing farming.

Second, the growth of farm incomes has been unsatisfactory in recent years. While most farmers now have enough food, disposable cash income is very limited. There are several reasons for this. As production costs increase, returns from farming have declined in recent years. Much of the value-added in the processing of agricultural commodities is obtained by urban industries and farmers benefit little from it. Although there is scope for farmers to adjust the structure of farm production, this has been hampered by the food self-sufficiency policy. Farmers have not been able to move to production of high value-added agricultural commodities as they should have without policy distortions. The development of processing industries in rural areas has also been slow, and the pace at which rural township

enterprises absorb surplus labour has slowed in recent years. Despite this, farmers face restrictions in searching for employment opportunities in other areas, especially in cities. Local taxes and charges have also been increasing. The central government has not been able to alleviate these burdens effectively despite several attempts.

Third, both private and public investment in agriculture has been inadequate. Agriculture has not been given priority in public investment despite the rhetoric. The slow growth in rural incomes gives farmers limited capacity to compensate for the decline in public investment. The state-controlled farm procurement agencies have issued so many IOUs that many farmers face a liquidity problem. The instability of the current land tenure system has also increased uncertainty over long-term investment. The lack of agricultural investment raises the question of the sustainability of China's agricultural development.

These problems are well recognised, but there is disagreement about the timing of further reform. This has more to do with political will than the economic environment. There are several favourable conditions for the acceleration of economic reform at present.

First, the domestic agricultural market has stabilised after the price hikes in 1993 and 1994. The bumper harvests in 1995 and 1996 played a critical role in changing market conditions. Barring any major disasters, agricultural prices will remain stable for at least the next couple of years. Even with moderate disasters, large grain stocks at present can prevent major price increases in the near future. The stable domestic market has created the much needed social and political environment for further reform. Past experience has proved that reform can be much more easily carried out during economic upturns.

Second, the overall macroeconomic environment is also conducive to further agricultural reform. After several years of serious macroeconomic instability, China achieved high economic growth with low inflation in 1996 and 1997. This looks likely to be maintained if the government continues to follow prudent macroeconomic policy. The stable macroeconomic environment should halt or slow down the flow of resources from agriculture to the urban economy, especially to the real estate sector. Stable prices for agricultural inputs will also increase the confidence of farmers in agricultural production.

Third, more experience in rural reform has been gained. In Fuyang County, Anhui Province, experiments have been carried out extending land tenure for another 30 years. In addition, family land holdings are not subject to change with change in family size. These policies have

substantially increased the certainty of land tenure. In Shanghai and several other places, experiments have been carried out abolishing the monopoly over grain marketing by the state commerce sector; agricultural and land reclamation departments are now able to participate in grain marketing. In a number of provinces, pilot programmes have been carried out by the State Council and the Ministry of Agriculture to increase employment opportunities for farmers. Reform has also been pursued in clarifying the ownership of rural township enterprises; many of these enterprises have been turned into shareholding companies. Agribusinesses have also emerged, further integrating farming with agricultural processing and marketing. All these experiments and reforms have provided valuable insights into the direction of further reform.

Fourth, major urban reforms will stimulate rural reforms and provide greater opportunities for the agricultural population. Despite more than a decade of reform, the urban economy, especially the state sector, is facing major difficulties. There is great pressure for structural adjustment. Underutilisation of productive capacity is widespread among state enterprises, and financial difficulties have worsened in the past few years. This has increased fiscal pressure for both the central and local governments to accelerate urban reform. As urban reform proceeds, a level playing field in the urban economy will emerge, providing rural enterprises and population with greater opportunities in investment and employment. If the shareholding system is implemented, transaction costs between rural and urban enterprises will be reduced.

Major policy issues

The farming system

Current debate on the farming system is primarily concerned with land tenure. Current government policies on land tenure can be summarised as follows:

- Farmers are entitled to use their farmland for another 30 years,
- Family land holdings are not subject to change when family size changes,
- Transfers of land use right are permitted under certain circumstances,
- Scale economies are encouraged where it is appropriate to exploit these.

Unfortunately, these policies have not been fully implemented. Only 62 per cent of villages have so far extended land tenure, and of these, only 20 per cent have extended the contract for the full 30 years. Other policies on farmland have been carried out to an even lesser extent, although the coastal regions have made more progress than inland regions. Implementation of these policies has been hampered by continuous disagreement. Some firmly believe in the viability of the current system of family farming. They stress the importance of a clear delineation of property rights and argue that once rules are established and land transfers are allowed, scale economies will emerge with the development of the market. Others contend that the current system of family farming faces serious constraints and is unable to exploit the economies of scale, thus government interventions are necessary to address this market failure. Policy recommendations from these two schools of thoughts are profoundly different.

Agribusiness

After nearly two decades of reform, farmers have enough food, but they need to increase their cash incomes to participate in the overall growth of the Chinese economy. This raises the question of further integration of agriculture with the rest of the economy, especially with the activities relating to agricultural processing and marketing and trade. This seems to be an effective way of increasing farm employment and incomes. Since 1993, many agribusinesses have emerged in various parts of the country. Some provincial governments have formulated policies to promote agribusiness.

In connection with the disagreement about the farming system, two different approaches to the development of agribusiness have been proposed. One group argues that the development of agribusinesses must be built on the family farming system. Once natural and policy impediments are removed, farmers will have incentives to integrate farming with rest of the economy. Those who advocate the alternative approach regard agribusiness as a way of addressing the inefficiency of the family farming system. They argue that the government should *intervene and restructure the current farming system so that it can be transformed into a modern farming system based on specialisation of production and economies of scale.*

Grain production and marketing

In response to grain surpluses in 1991 and 1992, 98 per cent of counties deregulated grain prices by the end of 1993. Unfortunately,

there was a small downturn in grain production in 1994 and grain prices soared. As a result, the original regime of grain procurement and marketing was restored. To boost grain production, the provincial governor grain responsibility system was established, and procurement prices were raised. 1995 and 1996 saw bumper harvests. As a result, grain was seriously overstocked in some provinces and grain prices were depressed. As a new round of policy response, several policy initiatives are being considered. The main reform proposals are as follows:

- State-owned grain enterprises should be delinked from government administration,
- The procurement prices of grain should be in line with market prices,
- To enable the state to intervene in the event of large price instability, the government should maintain its current quota for grain procurement,
- Floor prices for grain should be established to protect farm incomes,
- While government controls over grain prices are loosened, subsidies should be maintained only for low-income urban dwellers, students, the military and poor people in the mountainous areas,
- A vertical, central government-controlled grain reserve system should undertake the task of grain procurement, storage, distribution and sales, along with financial and personnel management,
- Free grain markets should be allowed to operate throughout the year and enterprises and individuals allowed to participate in trade in grain.

There are two potential problems with these proposals. First, fearful of losing control, the state still wants to purchase 50 million tonnes of grain every year. Second, if the state sets a floor price in line with the market price, the effects of the policy will differ by region since market prices vary greatly among regions and provincial governments support the floor prices out of their own budgets. Governments in grain-surplus provinces would be subject to severe strains on their budgets. Perhaps the biggest hurdle is the resistance to reform by vested interests in the Ministry of Internal Trade. Because of the Ministry's monopoly over grain marketing, further deregulation will reduce its political influence and revenue and force it to compete with other marketers.

There are two opposing views on grain production and marketing. One group believes that if farmers were allowed to manage production,

marketing, storage and processing, they could provide enough food for the country; the government need not fear losing control over grain supply. In addition, giving farmers more autonomy will reduce market instability and the costs of grain supply, and hence increase the competitiveness of Chinese grain production. Those opposing this view believe that there are serious constraints on the household-based grain production and marketing system and that increased autonomy for farmers will increase price fluctuations and adversely affect state control. They propose the government should play a more active role in grain production, storage and marketing.

Farm incomes and tax burdens

In 1996, per capita farm net income was 1926 yuan. Of this, 60 per cent was cash income and the remaining 40 per cent was imputed income in terms of subsistence consumption. While farm incomes have increased over time, charges and fees on farmers have increased as well. This has become a social and political issue. The central government has recently issued another set of regulations on the reduction of farmers' tax burdens. This has been welcomed by farmers.

There is a consensus on the need for increasing farm incomes both on economic and socio-political grounds, but opinions differ on how to achieve this. Some advocate further deregulation of the rural economy. This would increase farm incentives as well as household incomes by expanding non-agricultural activities where employment opportunities are greater. They argue that the role of government is to create a favourable macroeconomic environment for farm production and marketing and that the development of the market will ensure efficient structural change in the farming sector, especially in farm amalgamation and the specialisation of production. A well developed market will also increase food security. Opponents of further deregulation argue that if farmers engage in non-farm activities, it will adversely affect grain production, and hence state control of grain supply. They believe that rural-urban migration impacts negatively on the urban economy, pointing to the importance of agriculture in raising farm incomes.

One view holds that most of the rural tax burdens are the result of remaining elements of central planning in the rural economy. Large local bureaucracies have to be financed through administrative charges on farmers. As rural reform deepens, these bureaucracies need to be streamlined. However, there are people who believe that these

bureaucracies are necessary as they play an important part in mobilising rural resources. In addition, they believe there is a case for these charges based on social policy and public goods considerations. Thus, according to this group, stricter regulations and discipline are needed, not fundamental reforms to rural institutions.

Rural institutions

As rural economic reform proceeds, there is an increasing need for the reform of rural institutions. After the abolition of the commune system in the early 1980s, some reform of rural institutions was carried out, but little was achieved. Institutional reform was reactivated in the early 1990s as part of the attempted comprehensive administrative reform at the county level. The major changes in this wave of reform were to strengthen macroeconomic management and weaken sectoral fragmentation. Administrative interventions by local governments in the management of enterprises were curtailed and staff redundancy in rural institutions was reduced. Some progress was made, but there was a lack of coordination. The slow pace of urban reform also constrained rural institutional reform. Much of the achievement in the past needs to be consolidated.

There has been a worrying development in rural government—some government agencies have been turned into profit-seeking businesses in the name of reform. Many local government agencies abuse their administrative power by illegally imposing charges on farmers. At the same time, the provision of public goods has declined in many rural areas. There must be a clear delineation between government and private services.

There is also a dichotomy on the reform of the rural institutions. One view is that the current institutions are unable to meet the demands of rural development; fundamental reforms are required to reduce sectoral fragmentation and strengthen the vertical integration of rural production, supplies and marketing. Rural institutions should focus on the implementation of government policies and legislation rather than direct involvement in enterprise management. Abolition of redundant institutions and the amalgamation of fragmented sectoral departments must be carried out. Policies need to target all sectors of the rural economy (agriculture, industry, commerce, research, education), not just agricultural production.

In contrast to this radical proposal, some believe that there is no need for such fundamental reform. They argue that because of the vast

number of small farms, it is more effective to strengthen sectoral departments to deliver efficient public services. As for the increasing need to deal with the issues arising from horizontal and vertical integration in the rural economy, they propose that institutions be established to coordinate sectoral activities. It is believed that this approach will minimise disruptions to existing institutions and therefore face less resistance.

There is consensus on the need to reform; the difference lies in what reforms are needed. This difference is not trivial. The pace of reform has been slowed by continued debate on the merits of different reforms. Resolute policy directions from the central government are required so that the process of reform can accelerate. Continued delays in making important decisions mean reform will fail to keep up with the increasing demand for more effective and efficient rural institutions.

Challenges and options

In the decades ahead, China has to meet challenges arising from three fundamental changes in the economy:

- The transformation of a largely agricultural economy to a modern industrial economy,
- A continuous transition from central planning to a market-oriented economic system,
- The internationalisation of the Chinese economy.

China is a large developing country with a population of 1.2 billion. Economic and social development varies from region to region, and cultural diversity across regions is significant. To meet these challenges, economic policies need to be formulated on the basis of regional diversity.

In the process of industrialisation, productive resources will move from agriculture to secondary and tertiary industries. At the same time, demand for agricultural commodities will continue to grow rapidly as income levels increase. How to absorb the released rural resources, particularly labour, into non-agricultural industries while ensuring adequate food supply is a difficult task, particularly given the increasing interdependence of various sectors of the economy. Any policy targeting a particular sector will have major impacts (intended or unintended) on other parts of the economy.

In the past, rural reform has been able to proceed ahead of urban reform largely because the overall macroeconomic situation has been relatively stable despite several episodes of high inflation. With a stable macroeconomy, rural reform can continue to precede and accelerate urban reform—the experience accumulated in rural reform can serve as useful lessons for urban reform.

There is an overwhelming consensus that China should move towards a market-oriented economy. In the process of this transition, friction between the old and emerging systems are inevitable. As the economy becomes more market-oriented, agricultural production in some regions will contract as a result of the specialisation of production in accordance with regional comparative advantage. This will be resisted by the institutions established in the central planning era which always try to achieve 'balanced' growth of regional economies. Existing institutions severely distort market signals, fragmenting the national economy. This is exacerbated by the high degree of subsistence production and self-sufficiency at the regional level. With fragmented regional markets, uncertainty increases and farmers are hesitant to integrate their economic activities into the market.

This does not imply that the current family-based farming system is inconsistent with the marketisation of the rural economy. The family-based farming system is the foundation for the continued transition to a market-oriented rural economy. In the past, this system has responded very well to major natural and policy shocks. Food supply since the introduction of this system has been better than at any time in Chinese history. The key strategy in promoting marketisation is to remove both natural and policy barriers which hinder its development. In the process of integrating farming and non-farming activities, the family-based farming system continues to provide the clarity of property rights needed in increased economic interdependence.

Further internationalisation of China's agriculture is inevitable as China continues to pursue membership of the WTO. There is a great need for the introduction of foreign investment, technology and managerial skills into China's agriculture. If policies are appropriate, this type of internationalisation should assist structural adjustment in agricultural production and trade, thus increasing the efficiency of agricultural production. Globalisation will also help the development of the domestic market by increasing competition and reducing regional fragmentation. Regions will be in a better position to exploit their

comparative advantage. China needs not only technology transfer in agricultural production, but also in marketing and trade.

In the process of internationalising, market development will accelerate. This applies not only to commodity markets, but also to factor markets. A well developed domestic market would improve the competitiveness of China's major agricultural exports as well as improve overall domestic resource allocation. Past experience shows that market fragmentation may lead to excessive exports, and terms of trade losses for the country. Insulation has failed to stabilise the domestic market. In many cases, the current trade system has exacerbated price fluctuations in the domestic market. Failing to respond to domestic demand and supply conditions has not helped improve domestic resource allocation.

Policy recommendations

1 *Further reform of land tenure*

The uncertainty surrounding land contracts must be removed by enforcing government policy and extending the land contract for another 30 years. Land holdings by families must be maintained regardless of changes in family size. The government should further clarify the details of land contracts. The new land contract should give farmers the full right to use, inherit and transfer land use right. A uniform land tenure certificate should be issued to validate land contracts. With this system of validation, land can be transferred in the forms of leasing, exchange, mortgage, and equity investment. Legislation on land tenure must be given a priority during the ninth five-year plan (1996–2000).

2 *Reforming the grain marketing system*

The government should only keep a minimal grain reserve to deal with emergency situations. This reserve should be of the right volume, variety and regional distribution. While the government should leave the maximum amount of grain for market transactions, it can play an active role in price stabilisation. Consumption subsidies should target those in need. As long as food security is not compromised, grain imports can increase, and exports of high value-added products, such as meats, vegetables and fruits, should be encouraged. Foreign trade in grain should be integrated with the domestic grain reserve system and wholesale markets to smooth domestic demand and supply. Grain trade across regions should be promoted. Legislation should be passed to ban regional protection

on grain trade. Particular attention should be paid to facilitate the cooperation of main grain surplus and deficit regions.

3 *Promoting agribusiness*

The promotion of agribusiness should be given high priority. Special government institutions may be established to coordinate policies on agribusiness. Assistance to agribusiness in the form of finance, taxes, land use, research, business administration and marketing should be provided. The government should also promote the establishment of farmers' professional associations and cooperative funds. Further reform to the rural supply and marketing cooperatives and credit unions must be rigorously pursued. This will improve the functioning of the rural capital market. Legislative work needs to be strengthened to establish clear property rights and legal contracts in various rural enterprises.

4 *Breaking the segregation of the rural from the urban economy, and facilitating rural-urban labour mobility*

The household registration system should be overhauled. Where possible, the barriers between rural and urban areas should be removed, first at the county and municipality levels. Farmers should be put on an equal footing in employment, in cities and the countryside. Government organisations should be established to coordinate regional labour migration and provide services for job-seeking.

5 *Deepening the reform of rural institutions*

The establishment of a long-term framework for rural institutions should be firmly on the agenda of rural reform. Comprehensive reform of rural institutions should be pursued rigorously. Although the pace of reform in other parts of the economy should be taken into account in reforming rural institutions, the overall direction of rural institutional reform must focus on the strengthening of legislation, law enforcement, development of markets, information provision, statistical and auditing work, resource and environmental management, science and technology, research and extension. Government organisations in rural areas should withdraw from direct intervention in production and marketing. The duties of the Party, governments and enterprises must be clearly delineated so that overlaps are avoided. The relationship between the central and local governments should be clarified and tensions between sectoral departments and coordinating departments resolved. Rural institutions must be streamlined and redundant staff minimised. Tax reform should also be on the agenda. Local governments should be

allocated adequate resources to carry out their essential grassroots functions. Illegal taxes and charges on farmers must be cut out. While the services provided by village-level organisations should be strengthened, farmers should be given the right to monitor financial management in these organisations. The number of village cadres who enjoy income subsidies should be reduced so that financial burdens on farmers can be reduced.