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## Where Will China's Future Interests Take It?

China's extensive reforms in agriculture both before and since its accession to the World Trade Organization have moved the country in the direction of its comparative advantage. This means the reforms are likely to be not only economically sound but also politically sustainable. China can remain WTO-legal while addressing poverty and distributional inequalities. Several essential questions remain regarding the future, however.

First, although economic analysis suggests that China's aggregate agricultural interests are enhanced by maintaining its current trade liberalization trajectory, do policymakers share this conviction? In other words, does China know what is good for it? Second, will successful negotiation of the current agenda of new WTO agriculture talks in the Doha Round serve China's interests as has the country's past liberalization?

Third, assuming Chinese policymakers understand their country's interests, do they have the political flexibility necessary to align policy with these interests by embracing further reforms, or by championing reciprocal market access among developing nations?

Finally, what are the near-term contentious issues both from China's perspective and from the perspective of those outside China looking in? Can these issues be managed to permit a broad consensus of interests toward greater liberalization?

### Awareness of Interests

Twenty years of growth based on a foundation of early agricultural policy reform have proven that change can be beneficial. Still, the process of

calculating China's national interests is imperfect. The nation's current agricultural policy reflects a combination of consultation between growers and governors, ideological zeal, vested bureaucratic interests, and debate over the appropriate institutional role the state should play in food policy.

China is just starting to look at its agricultural interests through the lens of economic modeling. In 1990, there were only a handful of people in China with doctoral-level training in agricultural economics. Human capital in policy analysis was so rare that it was nearly impossible to publish papers based on modern economic theory and methods in Chinese journals. Since then, thousands of students have received advanced degrees from domestic institutions and scores have returned from master's and Ph.D. degree programs in North America, Europe, Australia, and Asia. Today, China's agricultural economists teach their own quality Ph.D. students, participate in international associations and conferences, and regularly publish in international, peer-reviewed academic journals.

Several think tanks have emerged and are creating modeling frameworks that can be used to perform ex-ante policy analysis of the scenarios debated by policymakers. The State Council's Development Research Center has a general equilibrium model that has been used to forecast policy outcomes. The Center for Chinese Agricultural Policy of the Chinese Academy of Sciences has a detailed model that can analyze linkages between agricultural output, yields, sown area, rural incomes and employment, and key policy instruments such as investment in research and development, water control, market development, and the environment. Economists from the Chinese Academy of Agricultural Sciences, the Chinese Academy of Social Sciences, the agricultural university system, and elsewhere are able to use increasingly sophisticated theory and analytical tools to study questions of trade liberalization and the interaction of external economic deregulation and domestic policy shifts.

As a result, senior leaders increasingly know better than ever before the direction that economic policy needs to take. As questions become more complex, more predictive tools emerge that are being used with increasing success. There is evidence in China of action based on such research. For example, in mid-2003 the research community sent a number of policy briefs based on sophisticated economic analysis directly to Premier Wen Jiabao's office. These briefs presented arguments on current issues of concern based on quantitative research and policy options. Scholars in China are being told that their briefs are being used as the basis for new policy directives. This is a new and exciting phenomenon in China's agricultural policymaking and portends further policy reform.

## The WTO Agriculture Agenda and China's Interests

As has been stated throughout this study, China has an interest in seeing a successful WTO Doha Round negotiation on agricultural trade. China's reforms over the past 25 years have laid a solid foundation for further reform and marketization. The current state of reform and implementation of WTO accession commitments reflect a great degree of structural adjustment both within the agricultural sector and between agriculture and other sectors. The result has been superior productivity growth and income effects. These successes make the case for reform powerful and broadly shared, and make it politically and socially feasible to continue the reform process.

The current WTO agricultural agenda is centered on the pillars of market access, reducing export subsidies, and reducing trade-distorting domestic supports. In each of these areas, China's existing WTO obligations generally put it ahead of other developing members (and many industrial economies) in terms of reform. This means that further liberalization will disproportionately benefit China. On market access, China's bound and applied tariffs are lower than those of most other nations. China has supported modalities for tariff negotiation that would cut tariff peaks more deeply, though it fell back from that position somewhat in trying to work with the Group of 20 at Cancún. Tariff rate quotas (TRQ) are the key transitional nontariff barrier to market access, and here China agreed to new disciplines on administration of its TRQ system that other poorer nations have not taken on. The United States has proposed extending these disciplines to all WTO members, which is in China's interest as well.

On export subsidies, China's position is clearly in favor of further multilateral reduction. After all, it committed to eliminate its own export subsidies entirely as part of its agreement to join the WTO. While China does not appear to have eliminated all of those subsidies just yet, especially those for corn, the work that remains is essentially mopping up, and the commitments are in place and actionable.

On domestic supports, China is also in a position to support a liberal outcome to current WTO talks. Although in its WTO agreement China secured the right to use subsidies of up to 8.5 percent of the gross value of agricultural output accession (less than the 10 percent accorded other developing countries), this is far more than it currently uses. So China can expand domestic supports if it wishes while remaining WTO-consistent, and at the same time advocate a lower cap for developed and developing members.

There are, of course, many complex subissues to each of these pillars that require extensive negotiation. But an analysis of China's interests, including the informal positions put forward by Chinese agriculture

negotiators in Doha talks thus far, make it clear where China's interests lie. China has taken a self-interested position on special and differential treatment, asking that newly acceded members be granted exemption from new commitments. This is largely rhetorical. In WTO talks on non-agricultural issues, China has already stepped back from this blanket demand. WTO Agriculture Committee Chair Stuart Harbinson proposed a marginally longer period (two more years) for new members to phase in new commitments, a proposal retained in principle in the Derbez text used in Cancún negotiations.

Finally, some preliminary modeling using the China Agricultural Policy Simulation Model (CAPSiM; see appendix A) and a world agricultural trade model developed and run by the research team at Wageningen University have yielded projections as to how China would benefit from a strong Doha Round outcome on agriculture. The results suggest that there should be little surprise if China's leaders begin to push for agricultural trade liberalization. The model shows that China's overall welfare rises when the entire world cuts tariffs proportionally, and that Chinese exports, on average, expand more than imports. In general, China benefits more in welfare terms than almost any other nation in the world, primarily because it begins with average tariffs that already are the lowest, so it gives up less and gains more when there are proportional cuts.

## **Political Economy of China's Agricultural Policy**

China is in transition, with policymakers and technocrats well aware of macroeconomic priorities, and with growing evidence of reform taking an empirically driven course. On the other hand, there remain senior officials in government who take a more traditional stance less informed by tools designed to maximize economic welfare.

In the run-up to WTO accession, the senior officials responsible for negotiating China's terms and conditions hailed from the Ministry of Foreign Trade. Their negotiating responsibilities included, in the final stages, agriculture. The far-reaching commitments they made—including commitments that few if any other developing members were bound by—were then handed back to the Ministry of Agriculture for implementation. Not surprisingly, this led to some friction between bureaucracies. Agriculture ministry staff, having been left out of negotiations on final agreements, felt the Ministry of Foreign Trade should be more responsible for the outcome.

The first 18 months of WTO implementation thus saw internecine struggles between bureaucracies to sort out these responsibilities. The newly ascended premier of China's State Council, Wen Jiabao, served previously as the vice councilor with responsibility for agriculture. As

premier, Wen has pushed for greater cooperation between the various entities collectively responsible for both the design and implementation of agricultural policy. Some reports had it that he became impatient with the bureaucratic infighting that was impeding policy reform and WTO implementation. Document No. 1 issued in 2004 by the Central Committee of the Communist Party of China (CCCCP) reflects this impatience. In the most direct language ever, the leadership stated that farmers are an important part of Chinese society and should be able to enjoy their full range of rights as citizens.

But authority is still fragmented. Quarantine and quality supervision are the purview of the China Inspection and Quarantine Bureau; the Ministry of Agriculture holds the mandate to manage the lion's share of policy and implementation issues; the Ministry of Commerce (the restructured Ministry of Foreign Trade and Economic Cooperation) deals with such important issues on the negotiating agenda as technical barriers to trade (TBT) and sanitary and phytosanitary (SPS) rules. Meanwhile, more strategic policy formation takes place in commissions and bureaus that are a level above the line ministries. Interviews with Chinese officials in June and July 2003, along with a review of official government editorials and notices, suggest that efforts are being made to improve the quality of government performance in the sector.

One important sign of change and bureaucratic divergence came in July 2003 with the release of guidelines encouraging foreign investment in high-technology sectors. General guidelines on foreign investment issued in March 2002 had followed standing practice in China: ministries submitted recommendations to the Planning and Economic Commission as to areas where foreign investment should be either encouraged or excluded, and the Ministry of Commerce then incorporated these recommendations and put out the guidelines. The high-tech guidelines issued in 2003, however, came from the Ministry of Commerce and the Ministry of Science and Technology. In contrast to the previous guidelines, these explicitly invited foreigners to invest in cutting-edge transgenic product development, a major departure from the conservative attitude of the Ministry of Agriculture to keep foreign interests at bay.

An important component of policymaking in a market economy is formal and informal consultation between government and industry, including industry associations. China as yet has little effective consultation with industry, still less of it formal (mandated), and practically none with the private sector. Foreign embassy officials in China report being asked by private Chinese firms to raise issues with the government, for lack of a better way to communicate them. This should be an important part of the political economy of agricultural trade policy development. In China it is not—at least not yet. Firms with commercial interests can be a valuable asset for analysis and information, and China's government will want to take greater advantage of this asset in the future. This is already

starting to happen in industrial sectors, and one can expect within a few years for it to work its way into the agricultural sector as well.

## Managing Contentious Issues

Both China and its trading partners have laundry lists of contentions over agricultural trade and investment. Discussions with Chinese officials and scholars find them earnestly dismayed over new TBT and SPS barriers to Chinese agricultural exports that are popping up to replace tariffs, and quantitative restrictions on China's produce held to most favored nation (MFN) status levels by WTO disciplines. These trade barriers must be argued on their merits under current WTO rules, and it will be difficult for China to prevent overzealous use of these tools. Being one of the biggest victims of the misuse of barriers should impel China to improve disciplines on TBT and SPS rules through WTO Doha negotiations.<sup>1</sup> However, even a rather progressive WTO outcome on TBT and SPS issues would leave China's agricultural exporters exposed, because the weak link in their value chain is in processing, distribution, and handling, areas where TBT and SPS trade barriers tend to creep in. Domestic and foreign firms, international financial organizations such as the International Finance Corporation, and China's government itself are investing to upgrade this segment of the nation's agriculture, which could ameliorate this set of problems somewhat over time.

Another of China's complaints over trade regards the use of nonmarket economy methodologies to determine whether China's exports are being sold below market price, or being "dumped," as the expression goes.

China agreed as part of its accession to the WTO that it could be defined as a nonmarket economy for a period of time. However, China argues that in many cases a nonmarket economy method is now unreasonable and should be rejected for many industries where it now has competitive and unfettered markets.<sup>2</sup> Some countries cling to the right to use nonmarket economy calculations in order to inflate dumping margins for products where they are not appropriate. Others, including important potential partners on the WTO agenda, are willing to restrain abuse of nonmarket economy rules where there is a solid empirical basis to do so—regardless of whether China's WTO terms entitle them to it. Lardy (2002,

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1. Keep in mind that negotiation of these issues falls to the more proliberalization Ministry of Commerce, which represents China on the WTO Trade Committee, rather than the more conservative Ministry of Agriculture, which represents the nation in WTO agriculture negotiations.

2. See chapter 4 regarding market integration and price rationalization in most of China's commodity markets, although not, notably, for foreign c.i.f. (cost, insurance, and freight) prices for maize.

173, 230) notes that the European Union and Australia, important agriculture traders, have decided to apply nonmarket economy terms on a case-by-case basis in investigations of China's dumping.

From the outside looking into China, there also is a thick dossier of trade friction over agriculture. China has generally reduced but not eliminated TBT and SPS barriers to imports, as proscribed by its WTO commitments. It has eliminated export subsidies for most but not all domestic products, which it also is required to do. It has generally improved administration of a new TRQ regime, but continues to apply it ineffectively in some commodity areas, with the effect of denying some benefits expected by foreign interests.

Despite these lingering issues, all in all, the volume of many agricultural product imports is up significantly since China joined the WTO, and the areas where heated disputes continue seem to make up a shorter and shorter "negative list" of problem areas. It remains to be seen whether specific nonagricultural rules on domestic distribution and foreign trading rights—scheduled for full implementation by the end of 2004—will be contentious. In terms of these general commitments, most observers have been guardedly positive about China's performance. There is no reason at this time to expect that these trade and distribution issues will severely impede cooperation in the medium term, though implementation will likely be spotty and problematic, and no doubt there will be tough talk and heated disputes along the way.

Another set of issues concerns foreign investment in China's agricultural sector, not least investment in biotechnology. Part of the reason China has been hesitant to permit foreign involvement in biotech in the past is that international standards for crops that incorporate such technology are some way off. Beijing does not want key markets (including Japan and Europe) foreclosed to China's exporters as a result of embracing foreign investment from firms that employ those technologies. Regardless of whatever virtues or sins can be attributed to bioengineered foods, the fact is that China has already made a decision in its own domestic research initiatives to pursue such technology. Even in the short term, it appears likely that underlying mutual interests will mitigate frictions between China and countries promoting bioengineering. One sign of progress on biotech issues came in the summer of 2003, when the government lifted many of the limitations on investment in agricultural biotechnology research and encouraged investments in this area.

