

## World Agriculture & Trade



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# WTO Accession Will Increase China's Agricultural Imports

China is one of the world's largest agricultural economies, and its accession to the WTO and further integration into the world economy will lead to a wealthier and more stable international food system. Under the terms of accession, China's agricultural trade regime will be more open and responsive to global markets. Farmers in the U.S. are particularly well positioned to benefit from China's accession to the WTO because the farming systems and underlying resource endowments in China and the U.S. complement each other, providing opportunities for mutually beneficial trade.

WTO accession is the latest initiative in a process of liberalization in China's economy that will also benefit U.S. agricultural exports. A modest increase in China's imports of important bulk commodities in the next few years should result from the new trade regime under the WTO, but most benefits to U.S. farmers will occur several years down the road. China's imports of major commodities were expected to increase in the coming years due to internal market reforms and gradual economic liberalization even before China's formal accession to the WTO. Accession must be viewed in the context of China's broader economic development and its transition from a planned to a market economy.

### *China's WTO Agreement Revisited*

As part of the agreement for WTO accession, China made far-reaching commitments to lower tariffs and reform its trading system. Central to China's agricultural policy commitments in the WTO agreement is a system of tariff-rate quotas (TRQs) for several major agricultural commodities. While many countries now regulate agricultural trade through a system of TRQs, China's TRQ regime is unique in that it also has provisions designed to break the monopoly power of state-owned trading enterprises. In addition to TRQs, China committed to lower tariffs on agricultural goods not covered by TRQs. China will also eliminate export subsidies, apply sound science for any sanitary and phytosanitary regulations, and limit potentially trade-distorting domestic support provided to its agricultural producers.

Under China's TRQ regime, a specified quantity of imports—i.e., a quota—may enter at minimal tariffs, while over-quota imports are charged much higher tariffs. The TRQ levels are set for each calendar year. It is important to note that these are not "minimum purchase" agreements, and actual imports may fall short of the full quota amounts.

The TRQ system is designed to ensure that market opportunity, not bureaucratic decree, will determine the level of imports. To loosen the control of China's state trading enterprises (STEs) over agricultural trade, a share of the TRQ for each commodity is set aside for private and other nonstate trading enterprises. In addition, if an STE has not contracted to import its share of the TRQ by August 15 of the year, then the noncontracted portion of the STEs' share may be made available to nonstate trading enterprises.

While TRQ levels and state trading components have been determined only through 2004 (2005 for edible oils), the levels, tariff schedules, and state trading components liberalize over time, and the in-quota tariffs are low. For example, the TRQ for corn rises from 5.9 million metric tons (mmt) to 7.2 mmt from 2002 to 2004, and the tariff for corn imported within the TRQ is only 1 percent. Also over this period, the TRQ share allocated to STEs falls from 68 to 60 percent, and the tariff for corn imported above the TRQ amount falls from 60 to 40 percent. While STE share of the TRQ does not fall during this period for wheat and rice, the over-quota tariff does decrease. The TRQs for soy, palm, and canola oils decline to a flat 9-percent tariff rate by 2005, eliminating the TRQ for these commodities.

China is still working out the details of how the TRQ regime will be implemented, and those details will determine just how open China's market will be. China agreed that TRQ certificates will be allocated to end users (such as millers, crushers, and feed lots), and the certificates will specify whether users must import their portion of the TRQ through a state-owned or a nonstate-owned trading enterprise.

In February, China announced the application process for acquiring a portion of the 2002 TRQ. The wording of the TRQ allocation rules suggests that end users that are private enterprises will be allocated the nonstate-owned portion of the TRQ, while end users that are STEs will be allocated the state-owned TRQ portion.

There are a variety of unanswered questions and unresolved issues in the TRQ allocation process that may affect China's agricultural trade. These include:

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### China's TRQ Commitments at a Glance

	Wheat	Corn	Rice*	Cotton	Soy oil	Palm oil	Canola oil	Sugar	Wool
<b>TRQ level</b>	<i>Million metric tons</i>								
2002	8.5	5.9	4.0	0.82	2.5	2.4	0.9	1.8	0.27
2003	9.1	6.5	4.6	0.86	2.8	2.6	1.0	1.9	0.28
2004	9.6	7.2	5.4	0.89	3.1	2.7	1.1	1.9	0.29
2005	-	-	-	-	3.6	3.2	1.2	-	-
<b>State share of TRQ</b>	<i>Percent</i>								
2002	90	68	50	33	34	34	34	70	0
2003	90	64	50	33	26	26	26	70	0
2004	90	60	50	33	18	18	18	70	0
2005	-	-	-	-	10	10	10	-	0
<b>In-quota tariff</b>	<i>Percent</i>								
2002	1	1	1	1	9	9	9	20	1
2003	1	1	1	1	9	9	9	20	1
2004	1	1	1	1	9	9	9	15	1
2005	-	-	-	-	9	9	9	-	-
<b>Above-quota tariff</b>	<i>Percent</i>								
2002	71	60	60	54	48	48	48	50	42
2003	68	50	50	47	35	35	35	50	40
2004	65	40	40	40	22	22	22	50	38
2005	-	-	-	-	9	9	9	-	-

\* The TRQ for rice is split evenly between long grain Indica rice and short grain Japonica rice.

- = No quota established.

Economic Research Service, USDA

- whether STEs will respond to market signals or continue to trade according to politically determined levels of imports and exports;
- the role of government in reallocation of unused TRQ at the end of the year; and
- whether imports that are designated as inputs into re-exported products can comprise a set portion of the TRQ.

Over time, pressure from domestic users who want access to imported wheat, corn, and cotton will likely reduce some initial rigidity and bureaucracy that may plague the TRQ system in its infancy. In addition to the TRQ regime, China has made substantial commitments to limit trade-distorting policies in agriculture, which go beyond the WTO commitments of many of its trading partners. China has also agreed to reforms that will liberalize domestic marketing institutions, giving foreign producers greater access to inland markets. Tariff rates on many important agricultural products not subject to TRQs are significantly below pre-WTO rates.

### Effects of WTO Accession

USDA's Economic Research Service (ERS) estimated the effects of WTO accession on China's agricultural imports and international markets. Using the USDA baseline model, ERS analysts

altered aspects of the model to reflect China's more open and transparent trade regime, then compared the results with the February 2002 USDA baseline. China had not formally joined the WTO when 2002 baseline analysis was carried out, so its accession is not assumed in the baseline. The China component of the baseline model assumes rates of import protection under the rigid state trading system, by incorporating knowledge of 1) the difference between global prices and China's domestic prices, and 2) the inelastic price-response behavior of the STEs.

Under the TRQ regime, China will be less able to keep prices above international levels through state control of agricultural trade, so lower import protection rates and less rigid import price responses were incorporated into the model, with the results presented here as the WTO scenario.

Implementing the TRQ regime and tariff cuts is expected to have an immediate effect on China's agricultural imports. Imports of corn and wheat change the most under the WTO scenario, but imports of other key commodities also increase.

In the 2002 baseline projections, China is expected to be a minor net corn importer in the 2002-09 period (a minor net exporter for the first few years of this period). In the WTO scenario, China's

annual net corn imports were an average of 4.8 mmt higher than in the baseline, making China a net importer throughout the projection period. The 2002 baseline estimates China to be a wheat importer over the 2002-09 period, but wheat imports are 2.6 mmt per year higher in the WTO scenario, reaching an annual average of 7.3 mmt. While increases in corn and wheat imports are significant, China's annual imports of these commodities are still below TRQ levels for every year during 2002-09 under the WTO scenario, so there is little reason to expect the TRQs to fill in the near future.

China also imports more soybeans and soy oil under the WTO scenario—an annual average of nearly 0.5 mmt above the baseline for the period 2002-09. The small size of the import boost attributable to WTO accession is due mostly to the fact that the 2002 baseline already projects China to be a major soybean importer, with annual imports averaging over 21 mmt in the years 2002-09. Annual imports of soy oil are higher under the WTO scenario—by 0.2 mmt, a 25-percent increase from the 2002 baseline level of 0.8 mmt.

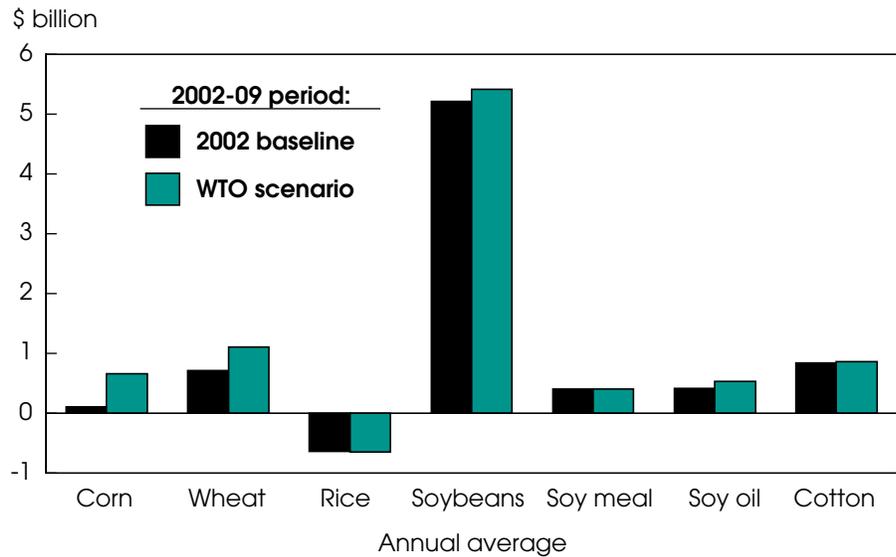
The ERS estimates are consistent with the intuition and observations of many China analysts. Studies have shown corn and wheat to be protected by China's trade

regime, and domestic users of these commodities in China have wanted more access to imports for the past several years. China's corn exports are also expected to stop due to the commitment not to use export subsidies. While soybeans have also been protected in the past, China has invested heavily in crushing capacity for soybeans and other oilseeds in the last few years, and these facilities are positioned to rely on soybean imports. Rice and cotton will be less affected by WTO-induced policy changes because recent changes in the procurement system have reduced internal prices to levels competitive with world prices.

But the ERS estimates do not take into account other non-WTO-related policy changes that may affect China's agricultural imports in the coming years. Recent changes concerning genetically modified (GM) crops may curb imports in the next few years. On March 20, 2002, China began requiring all GM crops to be labeled and accompanied by a safety certificate. In early March, China agreed, temporarily, that exporting countries' safety certifications will be honored while China carries out its own certification, which may take as long as 270 days. Future changes in this policy could impede imports of U.S. corn and soybeans, both of which contain GM varieties.

Producers in the U.S. are expected to gain from China's increased imports of wheat, corn, and other agricultural products. China's WTO accession will increase international demand and prices for these important commodities that U.S. producers export. Due to the increased export demand, farm grain prices increase, on average, by 0.5 to 3 percent above baseline levels over the 2002-09 period, and soybean prices increase an average of 2 percent. Average annual value of U.S. exports will increase by \$0.9 billion, and the annual value of cash receipts will increase by \$1 billion over the 2002-09 period. Taking the increase in production expenses into account, annual U.S. net farm income rises an average of \$0.8 billion over the period 2002-09 under the WTO scenario. These changes will also lead to marginally higher food retail prices.

### China's Net Imports of Most Grains Will Increase With WTO Accession



Economic Research Service, USDA

### The Long View

Beyond the immediate effects on import levels based on price differences and new trade rules, underlying forces will influence China's trade over a longer time horizon. Fundamentally, China's endowment of the basic factors of production, (land, labor, and capital) will determine which agricultural products are most profitable for China's farmers to specialize in and which to import from other producers. In addition, economic development already underway will boost food demand and commercialize China's subsistence-oriented farm operations. Finally, while China has made significant progress toward transition from a planned to a market economy, issues remain in this process that will affect future trade.

China's factor endowments will have the most profound effect on future agricultural trade, but these markets are still restructuring to allow farmers to choose optimal factor allocation. China has roughly 40 percent of the world's farmers but less than 10 percent of arable land, so China's comparative advantage clearly lies in labor-intensive agricultural products. Thus, the tendency will be for China to import more land-intensive grains and field crops, and export labor-intensive fruits, vegetables, and other specialty crops.

The adjustments needed to change the structure of production to take full advantage of trade liberalization are hampered by the slow mobility of factors of production. Land is still collectively owned by villages in China, and villages in turn allocate land use rights to farmers. While land rental is possible, it is not common, nor is it easy to transfer land to its highest valued use. Rural laborers cannot freely move to cities—where most nonfarm jobs are found—and formal farm credit institutions have only begun to emerge.

China's accession to the WTO bodes well for its long-term development prospects. As Chinese incomes grow and the population becomes more urbanized, diets will diversify and consumers will demand more meat, fish, fruits, vegetables, processed foods, and restaurant meals. Demand for feed grains will rise to support a growing livestock sector. This process will generate larger import demand in China and increased global opportunities for bulk feed grain exports to China. In addition, increased import demand for some high-value and processed agricultural products will generate opportunities for exporters.

Further economic development also will cause China's subsistence-oriented farm households to become wealthier and more integrated into the nonagricultural economy. When nonfarm earnings and farm

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### The World Has Changed Since 1999

In the spring of 2000, ERS evaluated the potential trade effects of China's WTO accession using USDA's February 2000 baseline as the starting point. That analysis indicated that China's entry into the WTO would increase U.S. agricultural exports by an average of \$2 billion per year during the period 2000-09. Of this \$2 billion figure, \$1.5 billion was estimated using the global baseline model, as in the present analysis. But the 2000 analysis exceeded the annual average \$0.9-billion estimate in the present analysis for the 2002-09 period.

Circumstances surrounding USDA's view of China's domestic agricultural policy and participation in international commodity markets have changed significantly in the 2 years since the earlier analysis. For example, USDA's 2000 baseline projections were heavily influenced by a pessimism regarding China's commodity trade participation related to the effects of China's "Grain Bag" policy of 1996-99. The "Grain Bag" policy had generated substantial domestic supplies and subsequent strong pressure to limit imports. However, over the past 2 years this pessimism has been displaced by the central government's rejection of the "Grain Bag" policy, as well as a commitment to market reform and trade liberalization in advance of WTO accession. This policy change was initiated in 1999, and was first incorporated into the USDA longrun projections for the 2001 baseline report, which raised China's projected imports of many commodities. With higher imports already projected in the current baseline even without the assumption of WTO accession, the boost from accession is not as large as earlier estimated.

Another important policy change in the last 2 years concerns the central government's policy vis-à-vis China's domestic oilseed crush sector. In mid-2000, China reversed previous policy and made a strong commitment to support the domestic crushing sector through strict border control of vegetable oil imports (including a value-added tax, high tariffs, quotas, and licensing). At the same time, restrictions on soybean imports were greatly eased. These policy changes had the effect of cutting off vegetable oil and protein meal imports, while accelerating importation of whole oilseeds for the domestic crushing industry. It is likely that China's oilseed policy will come under increasing pressure with accession to the WTO.

marketing receipts rise, farm households are more likely to purchase food rather than grow it themselves, and instead produce commodities that bring the highest returns. This will facilitate movement away from staple grains toward higher valued labor-intensive products.

China has made remarkable progress in moving away from a planned economy, but some institutions have yet to reform. It is hard to imagine that a little over 20 years ago all agricultural production in China was carried out according to bureaucratic decree. Today, the government procures only a very small percentage of agricultural commodities, and most farmers make their own decisions about what to produce. Barriers to transporting goods between regions and provinces have fallen significantly, and markets are becoming more integrated. Even grain markets—where the state-owned bureaus handled more than 70 percent of all marketings for most of the

1990s—are showing clear patterns of market integration and price responsiveness.

While the government has reduced its role in the economy, it has yet to establish reliable market information systems, develop transportation and market infrastructure, build an agricultural finance system, and modernize its legal system to clarify property rights, enforce contracts, and resolve disputes. Without the institutional infrastructure to provide these essential services, market development will be slowed and farmers will be constrained in their ability to take advantage of the opportunities provided by international markets. WTO accession, however, will facilitate the development of market-supporting institutions in China.

China's accession to the WTO is a positive development for China, the international agricultural economy, and U.S. producers. Under the WTO, China's farmers will be

better able to access markets for labor-intensive products for which they have a comparative advantage. All residents of China, not just farmers, will benefit from the role that WTO accession will play in hastening China's overall economic development and its reform of outdated institutions. Integrating a large and diverse agricultural producer and consumer, such as China, into international markets will serve to alter world food production and trade on an unprecedented scale. China's rapidly growing and urbanizing economy will increase export opportunities for farmers in the U.S. and other countries.

Estimates of changes in China's agricultural trade due to the new trade regime under the WTO suggest China will substantially increase imports of corn and wheat under the more liberalized trade regime, and the increased international demand for these products will raise farm incomes in the U.S. On average, increased access to China's market under the WTO will expand annual U.S. farm incomes by \$0.8 billion over the period 2002-09.

In the big picture, formal accession to the WTO is a reflection of broader changes underway in China that will continue for years to come. WTO accession solidifies these changes and sets the stage for further reform as China's economy becomes more transparent and guided by the rule of law. For the same reasons policymakers in China strove for WTO membership, they also are working to liberalize markets and integrate China with the world economy in ways that are independent of the WTO. Continued economic development and transition to a market economy, along with trade liberalization, will provide greater opportunities for agricultural exports to China in the future. **AO**

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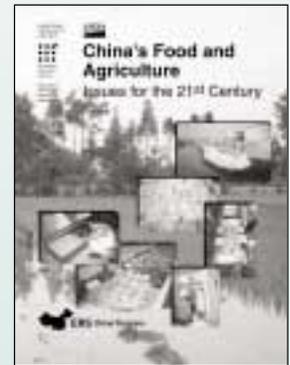
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## China in the new century

- How will China's rising incomes and urbanization affect food demand?
- How much reliance on feed imports for expanding livestock numbers?
- A maturing retail sector: Wider channels for food imports?
- China's regions: Can their markets be integrated?
- Will China attempt to protect and subsidize its farm sector?
- Will transportation and distribution bottlenecks be eliminated?
- Where are the nonfarm jobs for China's large rural population?
- ...and more

### *China's Food and Agriculture: Issues for the 21<sup>st</sup> Century*

Access it in the China Briefing Room  
on the ERS web site  
[www.ers.usda.gov/briefing/china](http://www.ers.usda.gov/briefing/china)



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## A focus on China's grain sector

China's grain sector faces pressure from both external competition and internal shifts in consumer preferences that could reshape the industry. What are the long-term expectations for China's agriculture in the face of its continued growth and its potential openness to trade?

### *China: Agriculture in Transition*

On the ERS web site  
<http://www.ers.usda.gov/publications/wrs012/>

