China's Continued Growth Leaves Agriculture Facing Changes

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Highlights: China's official GDP growth rate rose from 7.1 percent in 1999 to 8 percent in 2000, indicating recovery from some major external shocks, including the Asian financial crisis (1997-98). GDP is expected to continue rising at a relatively rapid rate as China maintains high levels of public investment and implements important reforms in accordance with its WTO accession agreements. Agricultural income growth, however, has not enjoyed the high rates seen in other parts of the economy, with 2000 agricultural GDP increasing only 2.9 percent over 1999. Continued progress in the nonagricultural sector will cause agriculture to undergo significant changes through competition for inputs and increasing demand for variety in food consumption.

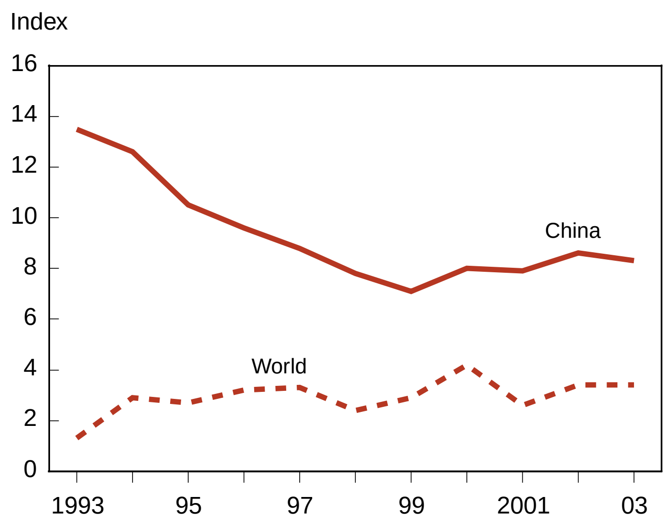
Growth Rate Rose in 2000

China reported a year-on-year rise in its gross domestic product (GDP) growth rate in 2000, the first year-on-year increase since 1993 (fig. A-1). China's official estimates show that GDP grew by 8 percent in 2000 (year on year), higher than the 1999 growth of 7.4 percent and above the government's year-2000 target of 7 percent. Although the accuracy of China's national income statistics is questionable (see box), most observers agree that economic growth has accelerated following recovery from the effects of the Asian financial crisis. The deflationary period brought on by the crisis is also over (China's Consumer Price Index rose 1.2 percent in 2000).

All signs have pointed to continued growth in 2001, although growth is expected to slow due to the global economic slowdown. The official GDP growth target for 2001 is 7 percent, but China reported an estimated 8.2 percent GDP growth rate for the first half of 2001, above even the 7.4 percent reported for the fourth quarter of 2000. While a global economic slowdown will put downward pressure on China's economic prospects, the slowdown is not expected to last long and information technology, the leading component of the current global slowdown, is not a large part of China's export sector. In addition, the effects of the slowdown on China's economic performance will be offset by domestic spending and increased foreign direct investment (FDI). If China's economic expansion does slow to the government target, China would still fare better in 2001 than most other Asian countries, as well as the European Union and the United States.

Figure A-1

China and world GDP growth



Source: USDA baseline. GDP figures for 2001, 2002, and 2003 are estimates.

Is China Really Growing That Fast?

Recently, a number of statisticians and economists, both inside and outside of China, have expressed skepticism over the accuracy of the country's official growth statistics. Much of this skepticism dates back to 1998, the year that high-level Chinese government officials "guaranteed" the country would achieve 8-percent growth despite the downturn generated by the Asian financial crisis. The statements by high-level officials are believed to have caused the elaborate statistical reporting system to find ways to meet that percentage, or a percentage close enough for the government to "save face." Observers point out that while some official statistics show GDP growth rates to be 7-8 percent in the late 1990s, other official statistics contradict them. For example, electricity and energy consumption, usually closely related to economic growth, grew at much lower rates or declined.

Western experts on China's economy and members of the statistical and policy-making community in China agree that overreporting production by grassroots administrative units exaggerates statistics measuring China's economic growth. Several scholars have published critiques and proposed solutions to the current "wind of falsification and embellishment" overtaking many lower level statistical reporting agencies.[1] Indeed, even high-level government officials have been critical of the rampant falsifications and no longer make strong public pronouncements on growth targets. Most skeptics are careful not to put the blame for the reporting inaccuracies on the National Bureau of Statistics (NBS, formerly the State Statistical Bureau), which publicly rejected the GDP numbers reported by the provinces in 1998, 1999, and 2000 and reported numbers corrected for overreporting by provincial bureaus instead. However, it is unclear how official numbers reported by the NBS were corrected and many consider it impossible to extract the correct number from figures that may have been altered capriciously at several levels of the reporting system.

The size and extent of reporting bias in China's official statistics has generated widespread debate. Some observers claim that official statistics overstated growth by about 2 percentage points throughout the 1990s. Other observers, such as Tom Rawski, professor of economics at the University of Pittsburgh, suggest that recent inaccuracies could be much greater, with actual growth in 1998 and 1999 likely hovering around zero. Fortunately, most observers agree that the overall economic trend is correct: GDP growth in China slowed in 1998 and again in 1999 but rebounded in 2000.

[1] Rawski, Tom, *China's GDP Statistics: A Case of Caveat Lector?*, working paper, University of Pittsburgh, Department of Economics, 2001.

Exports increased substantially in 2000 and may still be benefiting from policies introduced in response to the Asian financial crisis. China's government withstood pressure to devalue the renminbi during the crisis, when the currencies of many trading partners and competitors experienced huge devaluations. To accommodate exporters and maintain a strong currency, China implemented a number of policies to benefit exports. Direct budget outlays for export subsidies were officially abolished in 1991, but the government was able to promote exports through tax rebates, low interest loans, and other indirect subsidy programs. In 2000, trade surged as exports increased 27.8 percent and imports increased 35.8 percent over 1999. Rapid expansion of trade has continued in 2001. The recovery of other Asian economies and moderate growth in the United States helped to stimulate exports. However, China's trade surplus figures may have been reduced by a crackdown on import smuggling in 1999-2000.

Domestic demand rose substantially in 2000 and contributed to China's economic recovery. The government maintained its proactive fiscal policy and increased government spending by 10 percent from 1999 levels. Increased government spending is intended to improve China's infrastructure as well as boost domestic demand. In addition, consumer spending grew by 9.7 percent over 1999, the first increase in consumer spending growth rates since late 1997. In recent years, the government has implemented a series of policies designed to increase consumer spending, such as lowering interest rates paid on savings, expanding consumer credit, and extending official holidays. Due largely to these measures, consumer spending rose faster than GDP in each of the last 3 years. FDI also increased significantly in 2000 and early estimates point to rapid growth in 2001, as foreign companies scrambled to establish, or expand, their holdings in China to take advantage of the growth expected from WTO accession.

Economic progress in China, substantial as it has been, is uneven and concentrated in urban and coastal regions. Economic progress in many parts of China was stagnant throughout the high-growth years of the 1990s, and these areas continue to show little sign of becoming part of the country's modernizing economy. Typically, inland areas, such as Anhui, Sichuan, and Shaanxi provinces, have lagged behind coastal areas, such as Guangdong, Fujian, Zhejiang, and Jiangsu provinces. Agriculture's development has been slower than that of other sectors, so areas relying heavily on agriculture have seen little economic growth. For example, growth in value added, the value of output minus the value of input, was only 2.4 percent for agriculture in 2000, compared with 9.9 percent for industry. The stagnant agricultural sector is partly responsible for the widening rural-urban income gap. Per capita net income growth of rural households slowed for the fourth year in a row, to only 2.1 percent in 2000, while urban incomes rose 6.4 percent. Urban per capita income was 6,280 yuan in 2000, compared with 2,253 yuan for rural per capita income.

Reform Is Key to Sustained Growth

China is expected to maintain its relatively strong growth rate for the next few years, despite the expected global economic slowdown in the near term. To offset slowing demand for China's exports, the government plans to implement a variety of policies to increase domestic demand. In the recently released budget for 2001, China's government committed to large public investment and an overall increase in government spending of 9.3 percent. China continues to establish new policies and programs to encourage domestic consumption, such as a recent 30-percent increase in civil servant salaries and introduction of a social security program for urban workers. In addition, China's expected accession to the WTO will attract increased FDI and spur domestic demand. China already has the world's third-largest stock of FDI, about $350 billion, trailing only the United States and Great Britain.

Thus far, economic growth has come without expending much political capital on difficult policy reforms that will adversely affect well-established and powerful interest groups. Key areas in need of reform include the large and financially troubled state-owned sector, an ineffective tax collection system, and a banking system plagued with nonperforming loans. Not only do each of these areas resist reform efforts, but each area also is closely related to the other areas targeted for reform, making for a powerful unified front of resistance to changes necessary to bring about continued economic progress.

At present, there appears to be sufficient commitment to make difficult changes and forge ahead with the difficult task of reform. State-owned enterprise (SOE) reform has made significant progress in recent years, despite slow economic growth. The number of large and medium money-losing SOEs fell from 6,599 in 1997 to 2,501 in 2000. While this drop was achieved largely through merging unprofitable SOEs with profitable SOEs, total profits in the state-owned sector still rose 150 percent in 2000 to 242 billion yuan, up from 97 billion yuan in 1999. The rise in profits was due somewhat to high oil prices benefiting the huge state-owned oil companies; 63 percent of all SOE profits were made by the 10 largest SOEs, 3 of which are petroleum companies. Bank reform is also progressing, with the recent establishment of asset management corporations to absorb the nonperforming loans from the state-owned banks. In addition, China's leaders have begun to implement their WTO-accession commitments to reform trade practices and rules governing FDI.

Growth Will Bring Changes in Agricultural Production

Rapid growth in the nonagricultural economy will affect both the demand for and the supply of food in China. Rising incomes are clearly changing food consumption patterns. Demand for meat, fruits, vegetables, and other high-value commodities are rising rapidly. The per capita demand for staple food grains, such as wheat and rice, however, is not increasing as fast and may even be falling as consumers substitute higher value foods for staple food grains. Growing urban incomes will continue to put upward pressure on the demand for processed and higher quality foods, including high-quality food grains (see article "Surplus Wheat Production Brings Emphasis on Quality," in this report). As these changes in food consumption patterns are transmitted back to farmers in the form of price changes, agricultural production patterns are shifting to cater to the rising demand for meat, fruits, vegetables, and other high-value crops.

Liberalizing trade practices and further opening up the border will add pressure to reshape China's agriculture. Producers can be expected to respond to international market conditions. Some changes are already being made. For example, large areas in Shandong province have been converted from grain to vegetable production to supply inexpensive vegetables and other nongrain agricultural goods for consumers in Japan. Rising imports of inexpensive agricultural products from China has had such an impact on producers in Japan that Japan recently imposed temporary import protection on some Chinese agricultural products (shitake mushrooms, scallions, and rushes to make tatami mats).

The effects of rapid economic growth on agricultural production may be more significant on the supply side of the market. As the nonagricultural economy continues to expand, agricultural production must increasingly compete with the faster growing nonagricultural sector for important inputs, such as land, labor, and water, particularly in the more industrialized coastal provinces. Farmers will want to choose crops, crop varieties, and production methods so that the returns from land, labor, water, and other inputs used in agriculture rise until they are comparable to nonfarm uses of these inputs. As rural incomes grow and nonfarm sources of income become more common to farm households, farmers will be able to purchase staple grains instead of growing them themselves. This transition will allow many farmers to grow higher value cash crops instead, giving other farmers an opportunity to specialize in grain production or rely more on the international market for grain supply.

Agricultural Policies in Conflict

As economies grow and industrialize, they generally shift from policies that tax agriculture to policies that provide subsidies for agriculture so that agricultural production can be maintained in the face of higher value uses for important inputs. China's economic policies seem to be at a crossroads. While there are no nationally representative data on agricultural taxes at the local level, it is widely believed that local officials have increased agricultural fees and taxes recently to ease the mounting debt load carried by local governments. The national government, however, contends that it should have the right to protect agriculture (through subsidies) at a high rate as part of its WTO-accession agreement. Thus, it appears that China's national government envisions a day when it will subsidize its farmers as is done in developed countries. As local governments still rely heavily on agriculture as a tax base, continuing to do so would directly conflict with the national government's policy of subsidizing agriculture. In addition, differential taxation of agricultural producers at a time when those producers are learning to adjust to international competition and competition for important inputs will serve to impede the development of an efficient and competitive agricultural sector.

The national government in China also seeks to hasten agricultural development by allocating a large share of China's future public investments to projects that will benefit agriculture. As part of China's aggressive investment program, the government will put more money not only into roads but also into the water recovery, storage, and delivery infrastructure to expand irrigated acreage. China will also invest in research and extension of water-saving irrigation technology. China has earmarked money for research into high-yielding, high-quality, and technologically advanced seed varieties. In addition to making investments in public goods to increase agricultural production, China's central bank has announced that it will boost re-lending to rural credit agencies by 20 billion yuan ($2.4 billion) in the first half of 2001 to provide China's farmers more access to credit. This policy will make it easier for farmers to buy high-quality seeds, water-saving irrigation technology, and other modern inputs to increase the efficiency of agricultural production in China. In addition to these measures, the government is moving to reduce the tax burden on farm households by publishing uniform tax code regulations for localities to follow.