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978-0-521-55409-1 - The Third Revolution in the Chinese Countryside

Ross Garnaut, Guo Shutian and Ma Guonan

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1 The third revolution

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Mao Zedong's successful strategy for the Chinese Communist Party in the civil war was based on the building of political support and strength in rural China – on 'surrounding the cities from the countryside'.

The first revolution in the Chinese countryside was the land reform implemented in the 'liberated areas' and extended throughout China after the proclamation of the People's Republic in 1949. This was important in the consolidation of the Communist Party's political power. It was associated with early gains in agricultural production as order was restored to a war-torn economy, but these were swallowed up by the effects of the forced collectivisation of agriculture that gathered pace through the late 1950s.

The second revolution was the decollectivisation of agriculture and the shift to the household responsibility system as a basis for agricultural production. This was initiated locally in poorer provinces (Anhui and Sichuan), and generally sanctioned by the Central Committee from 1981. The household responsibility system spread rapidly throughout China as its success in raising productivity was demonstrated in the early 1980s.

The phenomenal increase in Chinese agricultural output from 1978 to 1984 resulted partly from the new system of production and partly from large increases in the relative price of grain and other food at this time. The growth in farm incomes was encouraged by the expansion of opportunities to sell a proportion of output at higher prices on local markets rather than to the state, as well as by opportunities to specialise and diversify production according to local comparative advantage.

The resulting explosion of farm incomes between 1978 and 1984 promoted further structural change as farmers sought outlets for their increased savings, and their surplus labour, in the new activities that were opening up in the more market-oriented rural economy. Rural non-farm economic activity expanded rapidly, in commercial services and manufacturing. The township and village enterprises in rural China became the most dynamic component of the national economy through the reform

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period. They absorbed large amounts of labour freed by rising productivity on the farms, and by the second half of the 1980s they had made the non-farm contribution to output and incomes in rural China greater than the farm contribution.

The second revolution in the Chinese countryside from the late 1970s set the scene for the third revolution: the freeing of markets for farm products, and the linking of domestic markets to international markets. The third revolution was always a necessary element of the 'socialist market economy' towards which China was groping from 1978, and which became explicitly the objective of the reforms at the Chinese Communist Party's National Congress in 1992; but it was always recognised to be politically difficult. The movement away from rations of grain and some other foods made available to urban residents at prices fixed by the state, and from large-scale purchases of farm products by the state at fixed prices, after four decades, increased uncertainty and was bound to be contentious.

In the event, the major progress on breaking the back of the old system of planned procurement and distribution, and on establishing a relatively free national market for almost all farm products for the first time in the history of the People's Republic, was made quickly between mid-1991 and mid-1993. This was rather earlier than anticipated by Chinese and foreign observers alike.

The third revolution is still in progress. It is inevitable that this profound transformation has teething problems. The expansion of the role of markets and market prices in domestic distribution was challenged severely in December 1993 and through 1994, when huge increases in domestic incomes and demand, and associated speculation, led to sharp and large increases in food prices. The knee-jerk reaction of some provincial and central officials was to re-impose controls, although this response was constrained by the absence or weakening of old mechanisms for state procurement and distribution.

One important element of the third revolution – the linking of domestic to international markets – has barely begun. The unification of the swap and official foreign exchange markets in January 1994 was an important precondition for effective integration into world markets. State approval is still required for most international trade in agricultural products, notably for grains. The centralised controls on trade have been so far relaxed only at the margins: for some transactions of foreign joint ventures, and in a limited way for some grain-deficit provinces in coastal areas. Chinese membership of the World Trade Organization (WTO) will require replacement of these controls by tariffs, and significant reductions of tariffs on commodities where they turn out to be relatively high.

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Issues and controversies

The third revolution in the Chinese countryside has spurred large changes in food and other rural output, consumption and trade. Already the markets are reflecting consumer preference for high quality produce with markedly higher prices, while low quality items are now sometimes difficult to sell. There are already signs of greater regional specialisation within China, with provinces or localities concentrating more on activities in which they are relatively efficient, and becoming less self-sufficient in other items. There are localised signs, too, of greater international specialisation – most notably in Guangdong province, where the extraordinary boom in economic activity in the early 1990s was associated with significantly reduced plantings and output of grain, accompanied by increased imports from other Chinese provinces and overseas.

The structural change and uncertainty of outcomes associated with the integration of domestic markets, and their linkage to international markets, have inevitably generated tension, debate and controversy. It is a particular source of unhappiness that growth in farmers' incomes has been slow in recent years. Grain prices have been rising – notably when inter-provincial sales have increased from grain surplus regions, and, pending further and deeper reform, this has sometimes increased fiscal burdens on local governments. Greater inter-regional specialisation requires freedom of inter-regional trade, and is the source of anxiety until confidence grows in the reliability of inter-regional trade. Free domestic prices seem to be less predictable, generating anxiety about food security. Linkage to international markets is widely felt to exacerbate price instability and supply uncertainty.

Few of these anxieties are justified by the underlying realities. For some of those anxieties that have some justification in reality – for example, the fear that inter-regional specialisation is risky in the absence of reliably free inter-regional trade – the superior solution is invariably deeper reform, sometimes associated with the building of new institutions. Still others – for example, the anxieties about widening disparity in income distribution as development proceeds in a market framework – require new fiscal policies as well as the deepening of market-oriented reform.

Feeding the people

It is remarkable that China has been able to feed, at standards that are comfortable compared with other developing economies, over one-fifth of the world's population with only one-fifteenth of the world's useable land (Lin, chapter 2). A crucial contribution to the extraordinary expansion of

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agricultural output in the reform period has been made by the change in the incentive structure facing farm households. Many weaknesses in the system of Chinese agriculture remain, including in price formation, and institutions for domestic and foreign trade. Further reform – the completion of the third revolution – is a necessary part of the solution to many remaining problems and weaknesses in the Chinese farm sector. This will lead to various regions in China specialising more in production of those agricultural commodities for which their economic capacities are best suited. For China as a whole, this is likely to lead to larger exports of labour-intensive products, and increases in grain imports (Huang, chapter 3). But while achievement of the ‘Third Revolution’ is necessary for continued progress in Chinese agriculture, there is no doubting the difficulty of moving ahead.

Trends in demand in the reform period show large increases in expenditure on food, in line with rising incomes (Garnaut and Ma, chapter 4). Since the mid-1980s, rising living standards have been associated with an overall fall in per capita consumption of grain directly by people, but a huge increase in indirect consumption of grain in such high-value foods as meat, eggs, dairy products and alcoholic beverages. The levels and pattern of Chinese food demand through the reform period have tracked closely those of Taiwan through the 1960s and early 1970s, when its per capita income in today’s dollars was almost three times that recorded officially for mainland China now. These trends are likely to continue with rising incomes through the 1990s. Rising domestic demand has underwritten the expansion of production in an agricultural economy in which international trade remains of marginal importance. The domestic supply of grain is unlikely to increase in line with demand in the future, in the absence of large price increases (supported by protection against imported food) or large subsidies to production. It would probably require both protection and production subsidies. China faces a crucial public choice dilemma in the course of the third revolution: whether to integrate fully into international markets, and accept large increases in imports of grain in one form or another; or to follow the precedents of Japan, Taiwan and Korea, into high protection for agriculture, high prices and heavy fiscal burdens (Ma, chapter 12 and Fang, chapter 13). Garnaut, Fang and Huang (chapter 14) show that these are now urgent issues. After suppressing agriculture in most of the years since the founding of the People’s Republic, Chinese domestic prices rose above world prices for several major food commodities. China has reached a crucial turning point, at which it must choose between protection and free trade. Choice will become harder, and the costs of change will rise considerably if internationalisation is delayed.

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The critical question of whether economic growth has been associated with the alleviation of poverty provokes a mixed conclusion: there was a large and rapid reduction in the number of people living in poverty in rural China in the period to the mid-1980s; but the rate of reduction slowed after that, and in some periods may have reversed (Riskin, chapter 5). There have been large regional variations in the rate of reduction of poverty. Location in western provinces is associated with higher probabilities of living in poverty, principally because of the scarcity of income opportunities off the farm. A majority of the poor are scattered through the population and not concentrated into officially designated poverty areas. Riskin draws an important conclusion that the effective transfer to the poor of a relatively small proportion of the incomes of people who are not poor would remove poverty from China.

Marketing and price reform

China faces dilemmas in price reforms (Li, chapter 6). There have been three phases of price reform. The latest, since 1991, has seen rapid movement towards determination of agricultural prices in markets, even for commodities like grain and cotton, the prices of which have been the focus of high political sensitivity. Many problems of China in the reform period have derived from weaknesses in the price structure, including irrational relativities between the prices of farm output and inputs. There is a considerable challenge in finding the right paths to market determination of prices, alongside effective regulation to make markets work better. The role of buffer stocks in generating price stability, and achievement of consistency between domestic and international prices as China enters the WTO, are aspects of this search. There are problems in the market system that have emerged since 1988 in the 'third revolution', the solution to which requires further reform. Many Chinese are anxious about price stability as the old state controls are withdrawn, and seek greater stability than seems to be ensured when prices are set in markets (Tang, chapter 7). This raises questions about the appropriate role of regulation in a market economy. Tang discusses the case for a continuing state role in stabilisation, through the maintenance of buffer stocks, as well as through a range of regulatory arrangements.

The prices of inputs – and in particular the price of fertiliser – can be as important to agricultural output as product prices (Zhang and Zuo, chapter 8). Past policies and contemporary reforms affecting fertiliser prices show that direct subsidy has been large, with much being spent to encourage the production of fertiliser, rather than of agricultural goods. A first requirement of an efficient fertiliser price regime is that any

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subsidy reaches its desired target – presumably the stimulation of agriculture rather than fertiliser output. A number of other distortions result from the remaining controls on fertiliser prices: excessive use in high-yield areas and deficient use in low-yield areas; irrational relative prices across different chemical fertilisers; and distorted choices between importing fertiliser and importing food. Price subsidies for fertiliser still remain a major burden on central and local government budgets. The solution to all of these problems is market-based reform. Some of the fiscal savings from reform could usefully be applied to assisting agriculture in more productive ways. Other important issues, such as the environmental consequence of using fertiliser excessively, have not yet become part of the agenda for discussion.

The growth of new wholesale markets during the reform period has been spectacular, especially when they have grown spontaneously, without government promotion (Xu, chapter 9). But once they have become important, their presence raises questions about appropriate forms and levels of government intervention. Where they are functioning well, they help to stabilise prices and widen the seasonal and geographic spread of consumption and production. Much can be learned from the successful operating markets.

The rural economy has experienced problems characteristic of partial reform over the past decade (Zhang *et al.*, chapter 10). Commodity ‘war’ or ‘chaos’ has emerged when local governments have had fiscal or other incentives to block the free inter-regional movement of commodities. Each case of chaos has its own fascinating features, but each has a similar cause, to which the solution is deeper reform to establish an integrated domestic market.

Vegetable marketing presents a remarkable case of institutional development, free of the political sensitivity of grain and oil markets, and therefore of tendencies for the state to apply pervasive controls. A highly sophisticated and differentiated national market for vegetables has developed. The result is fine regional specialisation according to climate, seasons and the value of land in alternative uses, all co-ordinated through markets with dispersed and rapidly changing and expanding consumer demand. Prices are free to rise, attracting produce from more distant places as demand increases, and as old supply sources lose their competitiveness with the rising value in other uses of land adjacent to the large cities. In the vegetable markets, problems of regulation remain, but the overall tendency has been towards rapid and productive institutional change. The scale of the trade in high-value fruit and vegetable products confirms the argument that we have made elsewhere (Garnaut and Ma 1993a) that China’s consumption patterns are those of an economy with

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substantially higher per capita income than is presented in the official data of China.

Internationalisation

The international dimension of establishing a market framework for Chinese agriculture introduces difficult issues for China, as for many countries whose resource endowments tend to generate increasing food imports in the process of economic growth. For China, the early revolutionary leaders' strong commitment to 'self-sufficiency', supported by memories of difficulties in obtaining access to world markets against the American embargo in the famine of the early 1960s, makes the internationalisation of grain markets particularly sensitive. While the 'self-sufficiency' reflex from Maoist days is weakening, there are still anxieties about food security and price stability. In reality, once China sought grain from international markets, it was able to obtain supplies from non-American sources; but the memories and associated anxieties are nevertheless important to Chinese discussion. Feelings of these kinds are now being challenged by the undoubted gains to efficiency and economic growth, and to productive international trade relations within the World Trade Organization (WTO), from maintaining open grain markets.

China's entry into the WTO will provide some opportunities to expand exports and the production of those agricultural products whose prices in China are now below world prices (Ma, chapter 12 and Fang, chapter 13). But economic growth, acting on China's low per capita endowment of agricultural land, will cause fewer and fewer commodities to be in this category, as both domestic demand for these products and the opportunity costs of producing more of them increase. Increasingly, open trade in agricultural products will force adjustment in Chinese agriculture, and contraction in production of some, perhaps many, items.

It is desirable that China expands imports and undergoes substantial structural change in its agricultural sector in the process of general trade liberalisation. It will be costly for Chinese development if this path is avoided. But there will undoubtedly be political pressures for resisting structural change, as there have been in other countries with low per capita endowments of agricultural land as their incomes have grown.

Regional issues

Guangdong, now together with Shanghai, is in the forefront of economic reform, internationalisation and economic growth in China. Some of the trends identified in Guangdong can be expected to emerge later elsewhere,

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at least in densely populated coastal provinces (Garnaut and Ma, chapter 15). The powerful tendency for rising incomes to raise demand for high-value food, and to encourage re-specialisation in high-value production in response to new market opportunities, has led to large reductions in grain acreage and output and large increases in flows of grain into Guangdong from other provinces and abroad. This has generated some protectionist responses, suggesting that China's eventual choice between open grain trade and Northeast Asian-style protectionism will face the usual range of political pressures.

There is a tendency for coastal provinces to reduce concentration on grain production as markets become more important in distributing output and allocating resources (Li, Watson and Findlay, chapter 16). There is also a tendency in those provinces towards net grain imports, while larger levels of inter-regional trade within China raise prices in provinces with comparative advantage in grain production and lead them to retain a net surplus for longer. There are large efficiency gains from inter-regional specialisation in production, and the resulting higher levels of trade in grain. But the realisation of these opportunities requires substantial reform of and investment in domestic trade and transportation, and recognition at the provincial level of the advantages of free movement of agricultural produce within China.

Rural incomes per person are much lower and growing more slowly in the central and western provinces than in the coastal (eastern) provinces (Ke, chapter 17). A striking conclusion is that the clear superiority of the coastal provinces over the rest is overwhelmingly associated with differences in off-farm economic activities rather than in agricultural performance. The cause is to be found in the proximity to and the close links with dynamic urban economies – a deficiency which will not easily be remedied in the Chinese inland.

Institutional change

Ambiguities now associated with property rights, especially in relation to ownership of township and village enterprises, are damaging performance. A response is to convert the various supposed rights that individuals in rural areas have in collective entities into shares in incorporated enterprises (Chen, chapter 18).

The fiscal arrangements between the various levels of government have created powerful incentives for local governments to encourage the growth of township enterprises. Some of these incentives complicate the process of efficiency-raising reform (Watson, Findlay and Chen, chapter 20).

At first sight, the household responsibility system has not served as well

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for tea as for other rural industries. Acreage, planting and production of tea have grown more slowly than during the Cultural Revolution. Closer examination reveals economic reasons why this might be expected. Tea requires good local 'public goods' to maintain quality and efficiency in processing and some other activities. There have been deficiencies in the supply of agricultural public goods under the reformed system, and this is an issue of general relevance. In the case of tea, however, part of the decline in plantings and output growth is the result of *increased* efficiency: tea was boosted artificially in the Cultural Revolution, with unsuitable land being brought into production (Etherington and Forster, chapter 19). It is economically efficient for some of this now to be left minimally attended.

Surrounding the cities from the countryside

The first and second revolutions in the Chinese countryside were carried along with widespread popular support. They were associated with large and rapid expansion in agricultural production, and helped to entrench the political position of the Communist Party.

It was later, when the first revolution was extrapolated beyond the initial program of land reform into compulsory collectivisation, that production and associated political problems emerged. It fell to the second revolution to restore incentives for high levels of agricultural output, yielding a spectacular response.

The third revolution is as important for long-term development in the Chinese countryside as the first and second. It is necessary for the supply of food and fibre to keep pace with the rising incomes associated with reform and growth beyond the farm. But it is more complex, more problematical, more politically contentious than the first and second. In its early stages it has thrown up contradictions and dilemmas, the resolution of which requires careful observation and analysis. The following chapters contribute to that observation and analysis.

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