

## **Policy Brief**

# Sino-German Agricultural Policy Dialogue to Promote Subsidy Reform in China



**Report by**

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## 1. Background

The Agricultural Policy Dialogue (APD) is one of the main components of German-Sino Agricultural Center (DCZ). In July 2016, DCZ Steering Committee had chosen “Subsidies” as the main topic for the third round APD in 2017. Prior to that, a MOA delegation, headed by DG Dept. of Sectoral Policy and Law Mr. Zhang Tianzuo, already visited Germany on the subject of EU’s direct payment policy.

According to OECD (2017), the level of China’s agricultural support stabilized in recent years after nearly two decades of constant growth. However, it remains at a high level on an international comparison and is characterized by market distorting policies, so-called amber box policies. Agricultural policy has to justify the high expenditures in view of budget, production, rural income, environmental effects and efficient administration.

## 2. Objectives

The main objective of the 3rd APD was firstly to get a comprehensive understanding of the EU support policies under the Common Agricultural Policy (CAP) scheme with a special focus on its implementation in Germany. Particular interest of the Chinese side was on available budgets, income effects, production, effects on sustainability goals, and efficient administration. Secondly, the German objective was likewise to get a better understanding of Chinese subsidy policies. Insights into the historical development and the current EU CAP may represent a valuable resource for China’s political decision makers, when aiming at market oriented agricultural policy reforms.

## 3. Activities

March/April 2017: Elaboration of an outline of all activities and identification of key policy experts and dialogue partners through DCZ.

May 9-13, 2017: Preparation visit of short-term expert Dr. Heinrich Hagel to DCZ and to main partner institutions, Chinese Foreign Economic Cooperation Center (FECC) and Chinese Academy of Agricultural Sciences (CAAS) in Beijing. Main objectives were: an introduction to the German agricultural sector and EU CAP, fine-tuning a second study tour program to Germany, and assessing specific points of interest of the MoA study tour delegation.

June 18-24, 2017: Second study tour to Germany and the Netherlands. Visited institutions in Germany included the German Ministry of Food and Agriculture (BMEL) and the Saarland State Ministry of Environment (MoE). Delegation leader from the Chinese side was Mr. Zhao Changbao (Dy. Director General, Dept. of Sectoral Policy and Law, MoA) and Dr. Dietrich Guth (DCZ Political Director) from the German side. All delegation members are listed in the APD mission report available at DCZ.

August 17, 2017: Workshop on Agricultural Support Policy in China and Germany, Beijing. Main objectives were: a) communicate findings and conclusions of the APD to a broader audience of experts from science, policy, and business, and b) discuss and reflect on those outputs in a broader public c) report and document recommendations. Over 100 high ranked experts and interested public participated in the workshop.

October/November 29, 2017: Discussion, dissemination and approval of Policy Brief to Promote Subsidy Reform in China by involved policy experts. Presentation of conclusions and Policy Brief recommendations to a wider audience during the DCZ Open Day event

## 4. Situation and Challenges in China

The implementation of a series of Chinese agricultural subsidy policies has promoted the development of “Three Rural Issues” and brought about steady and significant growth of grain

production and farmers' incomes in the last consecutive years since 2004. To some extent, more and more implemented single targeted subsidy policies (between 2002 and 2016) mitigated the effects of price fluctuation of agricultural outputs and agricultural inputs (fertilizer, pesticide and diesel) on the incomes of grain growers. But overall agricultural structural reform became critical in recent years with rising production costs that have offset the performance of the agricultural subsidy policies (and even revealed their misleading distortive long-term effects), reducing the competitiveness of Chinese farmers globally by increasing the gap between world markets prices and high domestic prices for certain commodities, discouraging crop rotation thus risking soil fertility, but also resulting in large government stockpiles of grains. Excessive subsidies allocated to stimulate food grain output have resulted in excessive production and reserves of maize. The annual amount of subsidies in circulation processes of grain and oilseeds nearly takes up 50% of total fiscal subsidy expenses. The intensification of agricultural production during last decades has put immense pressure on natural resources, contaminated about 19 percent of China's arable land, degraded about 40 percent due to over-fertilization, and accounts for 65 percent of China's water consumption.

Market Price Support (amber box) remains the dominant part of total agricultural support, though China gradually increases direct payments based on area planted (green box). The high cost of China's policies reflects the Total Support Estimate (TSE). It was 2.4% of GDP in 2014-2016, which is four times higher than the OECD average. (i) Public stockholding, (ii) development and maintenance of infrastructure, and (iii) agricultural knowledge and innovation system are the three categories that have the largest financial support.

In 2016, China extended a single payment scheme called "agricultural support and protection subsidy" to the whole country. The scheme combines three earlier area payments (direct payments for grain producers, comprehensive subsidy on agricultural inputs and seed variety subsidy) into a single area payment. Four-fifths of the funds allocated for this payment are intended to protect arable land fertility and to preserve grain production capacity and one-fifth to support large-scale production within so-called "new-style" farms. This is currently by far the most important budgetary support scheme for the Chinese agricultural sector.

Wide ranges of agricultural subsidies cut across many administrative departments such as finance, land resources, agriculture and banks. The irrational breakdown of responsibilities among concerned departments and the dispersed agricultural subsidy resources has led to poor coordination among different administrative departments during the execution of the policies. On top of that, the departmentalism, regional protectionism and rent-seeking activities have dragged down the efficiency of agricultural subsidies. Moreover, an effective carrier as a broker organization is missing between the government and the vast number of small scale farmers in China, which has resulted in expensive operation costs of many subsidy policies and inefficient operation of the subsidy funds. There are shortcomings in the supervision. Losses of the agricultural subsidy funds were about one third, either they had not been in place on time or not put in place, or been embezzled temporally or over a long period.

Reforming subsidies and promoting policy innovations towards sustainability is thus critical for a healthy and also more market based agricultural sector in China.

## 5. Conclusions and recommendations

Within the 3<sup>rd</sup> APD, a highly valuable dialogue between Chinese and German officials could be established. High ranked delegates and visited institutions, and the high number of participants at the final workshop indicates the relevance of the APD activities and in particular the chosen topic "Agricultural Support Policy".

Similar to current Chinese Agricultural Support Policy, EU CAP historically aimed at establishing food security and securing farmers' income through price support mechanisms. Market distortions and heavy overproduction in the 70s and 80s forced the EU to fundamental reform. Nowadays' EU CAP is

based on direct payments and rural development programs, thus it complies with WTO regulations, while also setting comprehensive environmental standards (e.g. by cross compliance). Several measures from EU CAP may support Chinese agricultural sector to achieve the planned development towards a more sustainable agricultural production.

However, EU CAP cannot be implemented one-by-one to China's agricultural sector. It has to be underlined, that all recommendations should be carefully evaluated in regard to the political agenda and require adaptations to regional circumstances. Current price support policies may be reduced to provide funds for the implementation of non-distortive agricultural support policies.

Considering the main findings from the conducted activities, the following recommendations can be made:

- 1) Implementation of direct payments to provide basic farm income:  
Direct payments per area present an efficient tool for farm income provision without causing market distortions and therewith complying with WTO regulations. A land register on national level is a prerequisite for the implementation of direct payments. Remote sensing facilitates monitoring of correct application and compliance with production constraints. Minimum farm sizes should be defined to achieve operability and significance of effects on farm income.
- 2) Setting environmental production standards:  
Towards a more sustainable agricultural production, environmental standards should be considered at national level. Due to the Chinese small scale agriculture, basic and easily controllable measures are recommendable. The following suggestions could be considered: a) crop rotation (e.g. with at least 2-3 different crops), b) riparian strips to ensure minimum distances to water bodies, c) prohibition of burning plant residues, c) annulment of support for mineral fertilizer and agrochemicals (also for small farms), d) promotion of circular manure use. Recommended farm sizes, at which environmental and animal welfare regulations appear viable, should be determined.
- 3) Annulment of subsidies for agricultural machinery as mainly medium sized and large farms benefit (see also study report by CAAS)
- 4) Introduction of a scientific policy planning and evaluation system: Agricultural policy decisions affect supply, demand, trade and prices of agricultural products. To support policy decision-makers to simulate both policy proposals and concrete changes to regulations, a "Model-based Policy Impact Assessment" could be applied. With a sound dataset at hand, these tools use economic models to identify the consequences of future policy changes. Models, databases need continuous maintenance and updates. A "baseline", which serves as a reference for further analysis, projects how agricultural markets and trade develop over the next decade given current policies. Relative to the projections of the Baseline different scenarios can be run, for example a reduction of subsidy payments or changes resulting from technological progress.

Besides those recommendations, fostering productivity by professionalization of farmers and production structures seem highly important. Rural development programs (e.g. investments in infrastructure, development of diversified on-farm and off-farm income alternatives) may support small scale farmers, which are negatively affected by structural changes and agricultural reform.

## 6. Sources and further reading

- DCZ study report by CAAS- IAED, Agricultural subsidy policies and its development in China
- DCZ mission report by Dr. Heinrich Hagel - APD on Agricultural Support Policies, Subsidies
- OECD Agricultural Policy Monitoring and Evaluation 2017
- China Daily, 2017-09-19, Reforms key to a healthy agrifood sector by Fan Shenggen