## Executive Summary:

The recent outcome of the December 2008 draft modalities (WTO 2008) signifies the progress that has been made since July 2008 and is a result of seven years of hard negotiations. Since China does not currently have export subsidies we mainly examine the implications of the modalities on their domestic support and market access in this study.

With respect to domestic support, China lacked a total Aggregate Measure of Support (AMS) mainly due to the managed prices being below the reference price level during 1996- 2005. However, their green box support increased each year while not displaying any historical blue box measures. In addition, since China is a developing country they are duty bound to reckon the special and differential treatment (Article 6.2 of AoA) in AMS. China's domestic support policies have changed greatly in recent years from taxing agriculture to supporting it. They are now reiterating that increasing farmers' income is at the top of the government's agenda. Recently they have begun a series of subsidies that are being put into practice, including direct payments to farmers, improved quality seed subsidies, price subsidies on farm machines, fertilizer, electricity, irrigation, fuels, agricultural tax elimination, minimum support prices to name a few.

The domestic support issue in the WTO revised draft modalities will have substantial restrictions on China’s domestic agricultural policies. The support to certain key products may exceed the limits in high-price (wheat and cotton) and medium-price (cotton) scenarios according to the projection results. The NPS (Non Product-Specific) support is far below the limits level when the recent subsidies are ignored but may be close to it if they are included. The new blue box limits are RMB 108 billions (5 percent of the average production value) overall. However, the effective and applicable space for PS blue box limits in total is only 30 percent of the overall blue box limits, which is 1.5 percent of the average production value. As a result the space left for China is now quite narrow. The rapid growth of agricultural expenditures and 8.5 percent production for the de minimis level (lower than other developing members) will gradually dwindle away the gap between the bound level and the actual outlays. Thereby, WTO regulations will be the important factors that affect China’s agricultural policy-making.

In the case of market access, all of China’s bound tariffs are of the simple ad valorem kind. This is where the simple average of bound tariffs is 15.76 percent while the trade-weighted average is 15.33 percent (1), which is only one fourth of the world bound tariffs. The Chinese agricultural tariffs are relatively low on average, which means that around 94.7 percent of the HS6 lines fall in the first band of the proposed tariff reduction formula in the draft modalities, and hence are subject to the lowest proposed reductions. Our analysis focuses on the tiered tariff reduction formula as well as the special and differential treatment afforded to developing countries. We assume that China will designate 5.3 percent of its HS6 tariff lines as sensitive products and two categories of special products: about 5 percent of the HS6 lines face no tariff cut and an additional 8 percent of the HS6 lines with a tariff cut of 16.6 percent.

(1) The results are calculated on HS6-digit level. As a recently acceded member, the tariff reduction committed by China was mostly fulfilled between 2001-2005.

Application of the proposed tariff reduction formula will result in an overall cut of 34.1 percent from 15.76 percent to 10.38 percent in the average tariffs, and 36.4 percent in the average trade-weighted bound tariffs from 15.33 percent to 9.75 percent. The application of the RAMs (recently acceded members) treatment would increase the rate to 12.34 percent. Flexibilities in the form of sensitive products and special products have strong impacts on China's market access, which increases the bound rates to 13.30 percent. This results into a net reduction of 15.60 percent, which is well below the maximum cut of 36 percent proposed for developing countries. Although the formula reduces tariff heterogeneity being measured by the standard deviation, flexibilities restore it to initial levels in key products that sustain potential distortions in Chinese agriculture. The average applied rate would fall to 7.19 percent from an initial 11.44 percent after the formula cut, however the flexibilities eliminate the reduction to 10.39 percent. In general, the tiered formula appears to be neutralized because the tariffs are distributed in only two bands and faced with the similar cuts. The flexibility increases heterogeneity in the protection pattern compared to the one after the formula cut.

As a RAM of WTO, China has already made substantial improvements in agricultural market access. The limited tariff rates and the tariff quota system have become the most important trade measures for China to protect their domestic market. The absence of flexibilities to adjust the tariffs creates a great pressure on further tariff reduction in China. The simulation results show that tariff escalation has small effects at the aggregated level. However, the additional liberalization of tropical and diversification products would have a noticeable impact on the average tariff. The impacts of the tariff reduction will be substantial as China is calling for larger reductions for developed members and moderate cuts for developing members. This approach complies with their defensive position to have enough flexibility in order to protect Chinese agriculture and preventing significant tariff reductions.

## 1. Introduction:

The December 2008 agricultural modalities are the result of a joint effort in promoting the progress of WTO negotiations. In order to assist the negotiators and policy-makers to decide how the proposed modalities correspond to the objectives set forth in the Doha Development Agenda mandate, we will examine the implications of the draft modalities for China in this paper, particularly on domestic support and market access. For this purpose, we use data from the China Statistical Yearbook, China Agricultural Statistics Yearbook and information from the China Ministry of Agriculture. Some results on domestic support are from Fuzhi Cheng (2008).

Agricultural issues in the Doha Round Negotiations are special and sensitive to China as they stick to WTO regulations and implement the commitments. The impacts brought by agricultural policies so far have affected Chinese agriculture profoundly. On one hand, the export market environment has improved drastically and agricultural exports have increased to a great extent. On the other hand, WTO accession has brought some negative effects such as the difficulties of agriculture structural adjustments and the challenges faced by some vulnerable agriculture regions and farmers.

The Chinese government has always stressed on the importance of agriculture. Due to the characteristics of Chinese agriculture, China has taken offensive and defensive stances in each of the three pillars at the WTO negotiation. On domestic support, China strikes for strict standards on green and blue box provisions as well as substantive cuts on OTDS (Overall Reduction of Trade-Distorting Domestic Support) for developed members. In the case of market access, China has simultaneously argued for tariff reduction and quota expansion of advanced economies to narrow down the unbalance of tariff levels and structures. China has also called for effective flexibilities for developing countries.

China is a country with mountainous areas accounting for 69.2 percent of the total land area and the people engaging in agricultural production consisting of 63.7 percent of the total population. There are nearly 0.9 billion peasants but owning 0.17 hectares per person which is equal to 1/6 of Japan, 1/30 of European Union (EU15) and 1/200 of America. The growing scarcity in water resource is and will be a major constraint to agricultural productivity. The reform on water resource allocation mechanism will have a notable impact on crop production costs and international competitiveness. The inadequate resources and low productivity of labor puts China in a disadvantageous position in international competition.

Chinese agriculture has some unique characteristics when we look at it from a global and trade perspective primarily because China is a large developing agricultural country. Agriculture has always been the foundation of China's national economy especially since they need to meet the food demand of over 1.3 billion people, as well as being able to provide livable wages and income to nearly 0.9 billion of its employees. The output scale of Chinese agriculture was $383.42 billion (Agricultural GDP) in 2005 which is more than two times of America and European Union (EU25), making China the largest in the world (2). In 2006, China was the world's largest producer of wheat and paddy, the second largest producer of corn and the third largest producer of soybean, cotton, beef and milk. Agriculture plays a significant role in China's social development, farmers' employment, poverty elimination and food security.

China made some concessions in regards to the WTO accession negotiation, market access expansion, export subsidies eliminations and domestic support reductions. Specifically, China reduced the average tariff rate to 15.76 percent in 2006 as committed and implemented tariff quota administration on wheat, corn, rice and cotton rather than planned management on foreign trade. Also, they gradually expanded the share of quota distributed to non-state trading enterprises. China has also committed to having no export subsidies for any single agricultural products. Since the AMS was zero and the special and differential treatments provisions given to developing members according to AOA were abandoned by China, the Chinese government then concentrated on green box support and limited de minimis of amber box support.

Chinese agriculture has changed greatly under these commitments. This paper takes agricultural trade as the main consideration since it has grown rapidly in China since its

(2) The data are from FAO Statistical Database.

WTO accession. As the fifth and fourth largest exporter and importer in world, China's trade quantity and value are listed on a tremendous scale. China imported 36 billion USD and exported 27 billion USD (3) in 2007. The opening up of the China agricultural market is quite a small duration compared with developed countries as well as some developing countries too. The complete liberalization of trade will decrease the employment by 6.6 percent and farmers' income by 3.1 percent in 2015, which is expected to be the largest loss in world (Aksoy, 2005).

The pattern of Chinese agricultural trade has changed greatly in the last ten years. Agricultural products such as fruits, vegetables, animal products and aquatic products have taken up dominant status in agricultural trade while cotton, vegetable oil and oilseed became the main import products. China's trade partners are quite intensive as imports mainly come from America, Brazil, Association of Southeast Asian Nations (ASEAN) and Argentina while they export to Japan, the European Union (EU), America, ASEAN and Korea. Their structure of products and markets keep improving while the processing stage of export products continues to move forward. However, the trade protectionism by some of China's trade partners has been critical due to its increased importance in the international arena and in world trade. Trade barriers and conflicts widely exist in China's exports as developing countries compete with them fiercely, while the costs of domestic agriculture production keep increasing. China has been a net importer in agricultural trade since 2004 with a deficit of 4.7 billion USD. The trade deficit has continued to grow rapidly these past few years due to higher costs in the international market and increased importing of raw materials. The financial crisis that began in 2008 has greatly affected Chinese agricultural trade, as the trade deficit in 2008 was as high as 18.2 billion USD, which is 4.45 times larger than that of 2007.

To meet the requirements of WTO accession and the changing conditions, the Chinese government has tried some positive policy measures to support producers and enterprises as well as improving international competitiveness of agricultural products in price, quality and reputation. China has also modified laws and regulations according to WTO rules and strengthened the transparency of technological measures. The Chinese government enhanced its services in creating an excellent environment for international trade and domestic policies. Free public information and food security monitoring have been given special attention by the government, including the infrastructure development, regional poverty alleviation and pollution control.

China's recent shift in agriculture development policy differs significantly from their previous and more tradition version. The Chinese government has adopted a series of new policy measures aiming at achieving a harmonized urban-rural development. As reported by the national government, the overall appropriation to agricultural and rural development from the fiscal budget of the national government rose from RMB 214.4 billion in 2003 to RMB 595.5 billion in 2008. Almost RMB 103 billion of that RMB 595.5 billion was allocated to the direct payments for grain growers, price subsidies for improving seeds, farm machinery and other inputs.

(3) The trade value comes from China Customs Database.

The opening up degree of the Chinese agriculture market is relatively high among WTO Members. Therefore in order to set up agricultural trade policies, China will look at the domestic and foreign market as a whole. Adjusting foreign trade of agriculture products and ensuring the balance of supply and demand in domestic markets are China's main considerations. The Chinese government adjusted the tariff rate and some other effective measures that were in accordance with the WTO provisions and international conventions in 2007 in order to guarantee the supply of soybeans. In regards to the promotion of exporting agricultural products, China reinforces its quality administration. They will also utilize the fund for agricultural trade development in order to support the quality of the traceability system and improving the technology of agricultural products. The measures such as optimizing the export commodities' structure and improving the surroundings will benefit Chinese agricultural trade.

China has been paying more attention to agricultural development than in previous years. The priorities of Chinese agricultural policies change with domestic and international conditions. However, the overall destination of agricultural policy is to supply sufficient food at stable prices and improve farmers' income. Therefore, China places a high priority on grain supply and the increase of income. Food security, environmental protection and the improvement of agriculture productivity are also of great concern. In general, the trend of agricultural policy development is to coordinate the economic and social development in urban and rural areas, secure the stable supply of food, enhance the function of the agriculture market and increase farmers' income and employment.

Does the modalities text imply any changes to applied domestic support levels in China? What are the likely constraints on domestic support? How much water will be cut and how much actual market access will be provided applying the general tariff cut formula? What would be the impact of sensitive products and special products on Chinese exports? What would it mean in practice? How would China be affected by special flexibilities for RAMs?

This paper attempts to address these issues, as a way of exploring the domestic and international implications of a modalities agreement. The first two sections of the paper give an overview of the current state of Chinese agriculture, agricultural policies and Chinese negotiating positions in this Round. The third section followed by an overview of China's domestic support policies and a discussion in more detail on the official notifications of the binding provisions and the potential impacts of the WTO draft modalities for China. We will then, provide an analysis on the impact of the draft modalities on China's market access. The impact analysis focuses on tariffs with and without flexibilities. Finally, we will make an overall assessment on the impacts of the draft modalities on China and conclude with some insights regarding the future of Chinese agricultural policies.