

## Chapter 2

# Agricultural Reforms

Reforms in China were first launched in poor rural areas. The earliest reform methods targeted individuals, were highly scattered, and affected only small areas at a time. The primary method of reforms was the implementation of the Household Responsibility System, which shifted the responsibility for both production and labor onto households. After agricultural collectivization in the 1950s, shifting responsibility onto households was one of the primary methods employed for peasants to respond to economic hardships around the country; that is to say that this was by no means a new tactic. What was new was the Chinese government allowing these methods to exist and offering support to the Household Responsibility System as it made possible marked gains in production. In order to bring about a consensus of the entire party and all of society, 1982s “Document Number One” demonstrated through argumentation the socialist nature of the Household Responsibility System and also advocated that no changes be made for a long time to either the public ownership system of land and other basic means of production or the Household Responsibility System. The centrally-issued “Document Number One” of 1983 made deep explanations to support the two conclusions that the Household Responsibility System was “a new development in the practical implementation of Marxist agricultural cooperative concepts in China” and “a great innovation of the Chinese peasantry.” Yet another “Document Number One” issued in 1984 extended the term for land contracting from three to 15 years. With the three “Documents Number One” in place, the Household Responsibility System was universally established across rural China. Once granted operational autonomy, rural citizens became incentivized toward production in an unprecedented way. The gross agricultural product rose by an annual average of 7.6% from 1979 to 1984, as calculated based on constant prices. With increases to the prices of agricultural products over the same period, per capita incomes of rural citizens increased by an annual average of 15%, and thus basic life needs were met for the majority of Chinese dwelling in the countryside.

The major method employed in the early period of agricultural reforms was the Household Responsibility System, meaning the contracting of collective land to a

household, which was to be responsible for production and management. All accounting and allocations of profits were still the responsibility of the village collective economic organization. Very quickly, however, the responsibility system came to encompass everything, with households now responsible for paying state taxes and fulfilling state agricultural product purchasing quotas, as well as paying contracting fees for the land to the collective; at this point village collective economic organizations no longer fulfilled obligations for unified accounting and allocations. Rural households were now the basic unit for production operations and economic accounting, and this set the scene for friction with the system of “three-tiered ownership with the production team as the foundation.” To remedy this situation, reforms were enacted upon the people’s commune system. These concrete measures were taken: production teams were reorganized into cooperatives; production brigades were abolished and replaced with administrative villages; and people’s commune management committees were abolished, with township governments established in their stead. By May 1985, this reform was carried out completely. Around the country 91,138 town and township governments and 940,617 village people’s committees were established, with villagers’ small groups established under village people’s committees.

Agricultural reforms in China were launched in line with two major themes. The first was the Household Responsibility System, aimed at tackling the challenge of rural poverty, and the second was opening to the outside, intended to tackle the challenge of development proceeding more rapidly in China’s periphery. This is the basis for that assessment: On November 18, 1978, the processing plant of the Shangwu Brigade of the Shiyan Commune of Bao’an County signed an agreement with the Hong Kong Yigao Real Estate Company, a subsidiary of the Hong Kong Electrical Co., Ltd., creating the country’s first “three imports and one compensation” enterprise, the Shangwu Electric (Shenzhen) Co., Ltd. This did not happen later than the Household Responsibility System of Xiaolan Village in Anhui. Shortly after reforms began, village collective economic organizations of Shenzhen not only adopted such reform measures as contracting responsibility to organizations, contracting production to households, contracting all responsibility to households, and allocating fields to households (Commune members were responsible only for turning over public grain and excess grain to higher authorities. Except that land still belonged to the collective, commune members had no economic relationship with their production teams.) and on the strength of their proximity to Hong Kong, they adopted measures for opening to the outside.

First, officials set their sights on the Hong Kong market and adjusted the agricultural production structure. From 1979 to 1980, Shenzhen converted 65,000  $\mu$  of rice paddies into 27,000  $\mu$  of fish ponds, 9250  $\mu$  of fish farms that included rice planting, 8621  $\mu$  of vegetable fields, 7910  $\mu$  of fruit orchards, and 12,000  $\mu$  of flower and medicinal herb gardens. These measures increased added value of agricultural products and rural incomes in the extreme. For example, the Fanshen Brigade of Nantou Commune raised fish and shrimp in 1350  $\mu$  of paddy fields suitable for aquaculture and developed an aquaculture industry geared toward

export, earning over 126,000 yuan from the industry in 1980. The Xinzhou Brigade of Futian Commune developed over 50  $\mu$  of fish ponds and 250  $\mu$  of reclaimed ocean beach to raise fish and shrimp.

Second, officials developed cross-border cultivation. Production teams located along the border with Hong Kong's New Territories planted vegetables, flowers, and other cash crops to be sold in the New Territories for Hong Kong dollars (HKD), which were then used to purchase means of production. In 1980, the Liantang Brigade of Fucheng Commune, located on the border, opened a factory and a farm on the border to grow vegetables and raise fish, earning more than HKD \$670,000 and earning income of 600,000 yuan for picking up waste. These two projects accounted for 44% of the brigade's total income in that year.

Third, officials developed horizontal alliances. The Futian Commune developed all manner of joint venture enterprises through such means as share-holding, dividend-sharing, and renting land. In 1980, these enterprises earned income of 2.7 million yuan, accounting for 24% of the commune's income in that year. The Xiamei Brigade, located in a rocky, mountainous area, cooperated with outsiders to develop quarries, tea fields, and other ventures, adding 126,000 yuan to income. The 15th Production Team of the Fenghuang Brigade of Fuyong Commune jointly operated a vegetable growing business with foreign merchants; revenues for the production team in 1980 were 43.1% greater than in 1979.

Fourth, officials developed a large-scale animal husbandry industry via compensation trade, establishing small processing companies for imported materials, assembly companies, and so on. There were a total of 426 compensation trade projects in Shenzhen by the end of 1979, which in 1980 generated over HKD \$27 million in processing fees and profit sharing. The Buji Commune developed processing of imported materials and construction materials manufacturing, and the commune's income grew from over 1.69 million yuan in 1979 to over 5.2 million in 1980, more than a three-fold increase.

Fifth, officials developed petty trading in frontier areas. Rural communes and brigades along borders were allowed to autonomously export petty amounts of agricultural products and by-products to the New Territories after fulfilling state purchasing obligations. Per incomplete data, total petty cross-border trading in Shenzhen in 1980 came to 18.74 million yuan, accounting for a quarter of total income. The Luohu District of Shenzhen abuts the New Territories of Hong Kong. In 1980, after the allowance of petty cross-border trading, the district earned revenue of over 18 million yuan, a 2.5-fold increase over 1978. The Yumin Village Brigade of Fucheng Commune benefited from its proximity to Hong Kong to develop a commercial enterprise combining fisheries, industry, commerce, and agricultural by-products. The brigade paid per capita allocations of 2000 yuan and per capita labor compensations of over 3800 yuan in 1980.<sup>1</sup>

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<sup>1</sup>Li et al., "A Look at the Superiority of Socialist Institutions from the Perspective of Changes in Rural Shenzhen," *Jinan University Journal (Philosophy and Social Sciences Edition)*, (1980) 4.

One perspective holds that the primary reason for the failures of collective operations in agriculture were the result of corporatization and communication causing work to be performed too hastily, too fast, and too crudely. Upon closer examination, however, one finds that this explanation isn't entirely tenable, as all problems caused by work being too hasty, too fast, or too crude will gradually be resolved over time, but these problems were never solved over a period of over 20 years. That proves that there were other reasons of inappropriate methods to blame in addition to work being too hasty, too fast, and too crude.

Agriculture's suitability to the Household Responsibility System is determined by some specific characteristics, such as the difficulty in effectively overseeing agricultural production, the difficulty of accurately measuring labor quality, and so on. Household operations bring about integration of production units and living units, as well as integration of production operations and family livelihood planning. Harmonious relationships founded upon blood ties can also maximally reduce costs of oversight, and so for all these reasons, household operations meet the demands of agricultural production rather well. It is difficult for collective operations to bring about effective oversight over agricultural laborers and to accurately measure the quality of their labor. It is also difficult for it to prevent some people from taking a free ride, and as time goes on more and more rural citizens feel less and less incentivized to engage in production. This is an important reason that we must persist in the Household Responsibility System for agriculture.

In addition to the Household Responsibility System, spurring incentives to produce of rural citizens by increasing the prices of agricultural products is another major reason that agricultural productivity grew during this stage. Per records, state grain purchase prices increased 20% at the time 1979s summer grains hit markets; prices for grain sold in excess of quota requirements rose 50%. There were also corresponding increases to prices of other agricultural products and by-products. In addition, prices for industrial products intended for agriculture, such as farm equipment, chemical fertilizers, pesticides, and agricultural plastic sheeting, all fell between 10 and 15% in 1979 and 1980.

The implementation of the Household Responsibility System triggered unconventional growth in agriculture from the beginning of Reform and Opening through 1984. The growth in agriculture it set off, however, was a one-time-only event. After the mid-1980s, growth in agriculture was primarily attributable to reforms to the circulation system for agricultural products, the fostering of a rural market system, and the effects of market mechanisms. In order to develop markets for agricultural products, China employed a method of gradual reforms, meaning a gradual transition from the planned economy into the market economy through price formation and the "dual-track system" of resource allocations.

The "dual-track" system of markets for agricultural products meant a synthesis of "adjustments" and "deregulation" to prices for agricultural products. In the early period of Reform and Opening, the central government greatly increased the purchase prices of agricultural products such as grains and also greatly increased the purchase prices for all grains sold in excess of quotas. So the more grain a farmer sold to the state, the higher the average sale price he received. Increases to agricultural

product prices directly touched off greater incentivization for farmers to increase investments and perform more multi-cropping. A study performed by Lin Yifu in 1992 demonstrated that the contribution rate of increases to agricultural product purchase prices to overall output growth over the years 1978–1984 was 16%.

## **2.1 Reforms to Markets for Agricultural Products**

Over the 25-year span from 1953 to 1978, purchase prices for agricultural products and by-products were extremely stable in every year except 1961, when the purchase price index increased 28% from the previous year. If the base purchase price was 100 in 1950, then from 1961 to 1977, the purchase price index for agricultural products and by-products increased from 201.4 to 209.8, less than an 8% increase over 16 years. In fact, purchase prices even decreased in the years 1962 and 1971. This demonstrates that the state monopoly system was indeed effective at stabilizing prices of agricultural products.

### ***2.1.1 Gradually Shrinking the Scope of the Agricultural State Monopoly***

In 1978, there were 113 agricultural products subject to state planning. In 1979, the state pushed reforms to reduce the number of varieties of agricultural products and by-products controlled by the state monopoly, to open rural markets and bazaars, and to restore the system of contract purchasing. In 1980, the state began adjusting the scope of products subject to the monopoly and planned purchasing. All agricultural products excluding grain, oil crops, cotton, sugarcane, tobacco, jute, tea, fruits, meat, eggs, aquaculture products, and wood—all of which remained subject to the state monopoly system—were classified as category three agricultural products and by-products. In 1983, the state continued reducing the scope of agricultural products subject to the monopoly, this time moving fruits from category two, still under state management, to category three. In 1984 the scope of the monopoly grew smaller still when the Ministry of Commerce reduced the number of agricultural products and by-products in categories one and two from 21 to 12, reduced the number of agricultural products subject to the state monopoly to three—grain, oil crops, and cotton—and reduced the number of products subject to the state quota system from 18 to nine, releasing tea, peanuts, beef, mutton, fresh eggs, apples, mandarin oranges, and tangerines from the quota system. In 1985 the state reduced the number of agricultural products subject to state price setting to 38, and again to nine in 1991. By 1993, only markets for cotton, tobacco, silkworm cocoons, and a handful of other agricultural products had not been opened. At this time only about one third of farmer revenues for commercial grain came from state planned grain purchases.

### ***2.1.2 Gradually Reducing the Quantity of State Monopoly Purchases***

Shortly after the beginning of Reform and Opening, the state adjusted the quantity of agricultural products purchased under the state monopoly to alleviate the burden on farmers. In 1979, the state reduced the planned grain purchase obligation by 2.5 billion kg. All state purchasing obligations were summarily rescinded for rice-growing regions in which per capita grain rations were 200 kilograms or less and in regions producing grains other than rice or wheat in which per capita grain rations were 150 kilograms or less.

In 1981, the state began promoting the contract purchase and sale system for agricultural products and by-products in an attempt to coordinate agricultural production and state planning. In 1983 and 1984, officials gradually reduced obligations for sale of agricultural products and by-products to the state monopoly system and promoted the development of agricultural products and by-products outside of government-mandated quotas. In 1985, the state ceased issuing quota obligations to farmers on all but a few select products. The state continued setting prices on commodity products such as grain, cotton, oil crops, tobacco, silkworm cocoons, sugar crops, and so on, but now implemented the contract purchasing system for these items. The state fixed prices on grain using the “reverse three-to-seven” ratio (meaning 30% bought at original monopoly prices and 70% bought at higher extra-quota prices). State-purchased cotton was priced at the “reverse three-to-seven” ratio in the North and at the “straight four-to-six” ratio in the South. Any agricultural products not subject to state monopoly obligations, as well as all grain and cotton produced in excess of quotas, could be sold by farmers on the free market. This is what gave rise to the so-called “dual-track system” for the sale and marketing of agricultural products and by-products.

### ***2.1.3 Gradually Developing a Market for Agricultural Products***

From 1978 to 1984, the total of policy-dictated subsidies on agricultural products grew from 1.114 billion yuan to 21.834 billion yuan, a 19.6-fold increase. Price subsidies on grain, cotton, and oil crops in particular grew from 1.114 billion yuan to 20.167 billion yuan, an 18.1-fold increase. As these subsidies led to major growth in fiscal expenditures, in 1985 the government pushed out reforms to the circulation system for agricultural products. Between 1991 and 1993, officials opened grain sale prices for urban residents to the market, thus eliminating the fiscal burden of “inversion”—buying high and selling low—between state purchase and sale prices for grain.

Reforms to agricultural product markets went through four stages. In the first, prices were adjusted, and markets were allowed to open. In the second, the planned

economy and market-oriented adjustments were integrated. In the third, market mechanisms were allowed to play a fundamental role. In the final stage, market mechanisms were allowed to play a decisive role. The order of reforms was: first an opening of rural markets for agricultural products, and then an opening of urban markets for agricultural markets; first an opening of local markets for agricultural products, and then an allowance of transporting agricultural products long distances for sale. There are three levels of connotation behind gradual reforms. The first is that gradual advancement of such is characterized by “going one step at a time.” The second is that the more important a particular agricultural product, the slower it is reformed, and the less important a product, the faster it is reformed, and so these reforms are characterized by being “sometimes fast and sometimes slow.” The third is that reforms advance when conditions are good but cease when conditions are poor, and so are characterized by “stopping and starting.”

After markets were opened, there was rapid development to all manner of market entities. From 1978 to 1984, the number of rural markets for agricultural products grew steadily from 33,000 to over 50,000. Total grain transactions in rural markets were not staggering, but growth in transactions was rapid, rising from 2.5 billion kilograms in 1978 to 8.35 billion kilograms in 1984, a 3.34-fold increase. By the end of 2004, the number of employees in state-owned grain enterprises dropped by 1.64 million from 1998, a reduction of 49.7%.

#### ***2.1.4 Expanding Channels for Circulation of Agricultural Products***

Hindrances to the circulation of fresh agricultural products led to problems of overstocking in local production areas and shortages elsewhere. In order to resolve this, in 1983 officials abolished the law requiring all out-shipments of agricultural products and by-products to be approved by local authorities and gave farmers the right to independently manage sales of fresh agricultural products. Farmers were allowed to enter cities and cross both county and provincial lines to sell agricultural products and by-products produced in excess of state quotas, with complete pricing autonomy.

In 1985, the state began reforms specifically targeting the circulation system for agricultural products. This marked a momentous shift in the focus of reforms away from the production and operation system toward the circulation system. The new method was to implement contract purchasing and market purchasing on different agricultural products per their different situations. In China, the scale and degree of market-determined pricing for agricultural products progressed gradually along the lines of the dual-track pricing system of planned prices and market prices.

In 1985, the state monopoly on grain and cotton was abolished in favor of the contract purchasing system. The first 30% of grain sold under the contract system was priced the same as under the state monopoly, and the latter 70% sold at original

extra-quota prices (again, the “reverse three-to-seven” ratio). Cotton sold in the South was priced at the “straight four-to-six” ratio, and at the “reverse three-to-seven” ratio in the North. All grain and cotton produced in excess of contractual purchasing requirements could be freely sold on the open market. After the abolishment of the state monopoly system, the “dual-track system” for grain prices formed, combining both state-set prices and market prices.

In terms of real results of these reforms, in 1985 many localities had not implemented reforms to convert from coercive purchasing into contract purchasing, as conditions were not yet ripe. The primary reason for this was that there was a great drop in Chinese grain yields in 1985, and market prices for grain grew over 10%, which caused market prices to be significantly higher than contractually-set prices. Owing to fiscal limitations, the government was not able to promptly increase contractual purchase prices. Farmers were willing neither to fulfil original contracts nor to sign new grain purchase contracts. This situation was remedied only after the bountiful grain harvest of 1987.

In 1992, the state attempted several important measures in making macro-adjustments to grain markets, including the establishment of a grain risk fund, a grain purchase price-protection system, and a state grain reserve system. These measures were not implemented, however, owing to insufficient capital.

With grain purchase and sale prices being regulated by the market, gradual development and stabilization of coordinated relationships between grain-producing and grain-consuming areas, and initial work completed in the establishment of a vertical management system for central grain reserves, the state’s ability to make macro-adjustments grew stronger.

In 2001, the central government opened grain markets and allowed for prices to be entirely regulated by markets in the eight key grain-consuming regions of Zhejiang, Shanghai, Fujian, Guangdong, Hainan, Jiangsu, Beijing, and Tianjin. In 2004, the central government completely opened all grain markets in the country, abolishing the institutions requiring licenses to transport and sell grain in different jurisdictions, while also strictly forbidding any regional blockage of free grain trade. Any operator meeting conditions was allowed to purchase and sell grain. This brought about an orderly, standardized nationally integrated grain market of fair competition.

All other purchasing quotas for agricultural products were also abolished. After 1984, large and mid-sized cities gradually withdrew from operations and pricing of fresh agricultural products, eventually giving rise to pricing mechanisms controlled by supply and demand on the market. This further gave rise to a network of markets for fresh agricultural products, with wholesale markets as their core and local markets as their foundation, typified by circulation through multiple channels and competition between a variety of economic entities. The central government completely opened up operations in fisheries products and allowed for market regulation; the market system for fisheries products has improved steadily ever since. Beginning in 1985, the state gradually abolished the state monopoly in edible oil. In 1991, all edible oil in China, except the portion going to urban rations or military use, became subject to supply via negotiated prices and market regulation.

In 1992, pricing in all oil crops except peanuts and rapeseeds, which remained under state control, was completely deregulated. In 1993, the deregulation was extended to all oil crops.

## 2.2 Agricultural Factor Market Reforms

The dual-track system was also employed in the growth of agricultural factor markets. By “dual-track system,” I mean that some pre-existing methods from before the implementation of reforms continue being used to protect the vested interests under the original order while employing new mechanisms for operations for newly added production under the new order. As the vested interests from the old order gradually grow smaller with time, it becomes correspondingly easier to push reforms onto those interests. Agricultural factor markets include labor markets, land markets, and financial markets, of which labor markets are the most dynamic. Financial markets at this time were both insufficiently dynamic and of insufficient scale. Markets for land contracting fell between the other two.

In 2005, rural production factors were 60.6% marketized, reaching the critical point for market economies (60%). Of those factors, labor was 80% marketized, land 52% marketized, and capital 50% marketized.<sup>2</sup> Labor markets grew by gradual advances. At first, urban and rural labor markets were divided, meaning that rural citizens could move about only in between rural industries, hence the term “leaving home without leaving the countryside and entering factories without entering cities.” Thereafter, urban and rural labor markets were integrated, giving rise to the ability to “leave home and leave the countryside and enter the factory while also entering the city.” Now rural laborers are not just leaving the countryside and entering cities, but the cities themselves are “receiving laborers and their families at the same time.” The process of marketizing land factor markets comprises both a gradual elimination of the urban-rural dual structure and the integration of urban and rural economies and societies, and also is a process of rural citizens realizing their property rights to their land. The framework for a pluralistic, competitive rural financial system has finally begun to take shape as financial organs of different kinds of ownership systems have been encouraged in counties; as great efforts have been made in fostering petty loan organizations founded by natural persons, corporate legal persons, or corporate aggregates; as the development of rural household capital mutual aid organizations has been guided; and as private loans have been standardized. Rural production factors have grown increasingly marketized as urban-rural integrated labor markets have gradually been established; as rural land markets have gradually come onto the track of rule-by-law; and as rural capital markets have gradually moved away from monopolies and toward competition.

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<sup>2</sup>Li Jing and Han Bin, “Report on Rural Marketization in China,” *Dongfangchubanshe*, August 2011.

### ***2.2.1 Reforms to Agricultural Input Markets***

Shortly after Reform and Opening, major agricultural production factors such as chemical fertilizers remained under the following administrative mechanisms of the planned economy: integrated monopolistic purchasing and allocation, and hierarchical management. In 1985, the central government made adjustments to the scope of important agricultural production materials under the unified distribution system, including chemical fertilizers. These production materials became subject to a price management mechanism that combined state-set prices, government guided-prices, and market-adjusted prices. This gave rise to a dual-track system for chemical fertilizers and pesticides. State regulation was eventually completely lifted on such production materials as plow animals, small and mid-sized farming implements, pesticides, farm equipment, and others.

In 1994, the central government changed the classification of chemical fertilizers from category one wholesale and category one retail to category one wholesale and category one retail. At the same time, the consignment sale system was promoted; it was not allowable for individuals to sell this product. In 1998, the government rescinded directive-natured production plans and monopolistic purchasing plans for chemical fertilizers, and allowed for manufacturers and companies selling fertilizers to autonomously buy and sell products. Factory prices for fertilizer were no longer state-set, but replaced with a combination of government-guided pricing and open retail pricing. By the end of 1993, 98% of counties (and county-level cities) had ceased to regulate grain prices and had allowed for market regulation of the production and circulation of other agricultural products. As the grain coupon system and state monopoly system were abolished, grain circulation left the “dual-track” system and entered the single track of market guidance.

### ***2.2.2 Reforms to Agricultural Labor Markets***

Soon after the founding of New China, there were no restrictions on the mobility of laborers, and most expansion of the urban population resulted from people moving to cities from rural areas, just as in other developing nations. In 1958, the National People’s Congress passed the “Regulations on Household Registration of the People’s Republic of China” to ensure ample labor for agriculture in the countryside and restrict growth of the urban population, who enjoyed low-priced agricultural products. The household registration system, also known as the *hukou* system, imposed rigorous limitations on the mobility of rural laborers.

### **2.2.2.1 Policies Restricting Rural Laborers to the Countryside**

The Household Responsibility System incentivized the masses of rural citizens to work more hours in agriculture and to seek more opportunities outside of agriculture. In the beginning, most such mobility flowed into the forestry, husbandry, and fishery sectors, but soon began flowing into rural non-agricultural industries. In the late 1970s and early 1980s, educated youths returning to their cities exerted employment pressure on urban centers. At this time the government passed policies restricting rural laborers to the countryside, touching off the “rise of a new army” in rural industry. From 1984 to 1988, the number of rural industrial enterprises in China grew from 4.812 to 7.735 million, an increase of 60.74%. The number of people employed in these enterprises grew from 36.561 to 57.034 million, a growth of 56%.

### **2.2.2.2 Policies Allowing Rural Laborers to Leave the Countryside**

In the mid-1980s, after pressure on urban employment had been alleviated, the government began relaxing restrictions on rural laborers that had prevented them from working in urban areas. This change in policy touched off the surge of migration of rural laborers. Over the three-year span from 1989 to 1991, the state of the macro-economy was poor, and so the central government twice issued urgent notices to place rigorous controls on the “blind migration” of rural laborers, demanding that governments at all levels either clamp down on or completely stop handling procedures allowing rural migrants to work away from home. In 1992, reforms to China’s economy came back on track, at which point rural migration picked up in intensity again.

As indicated in Table 2.1, in 1980, 20.28 million rural laborers, 6.37% of all rural laborers, were employed in non-agricultural industries. By 2005, that number had come to exceed 200 million people, an 11-fold increase over 1980, accounting for 40.51% of all rural laborers. In 2014, the figure was again up to 273.95 million, accounting for 50.5% of all rural laborers, which is to say that migrant laborers now account for over half of all rural laborers (Fig. 2.1).

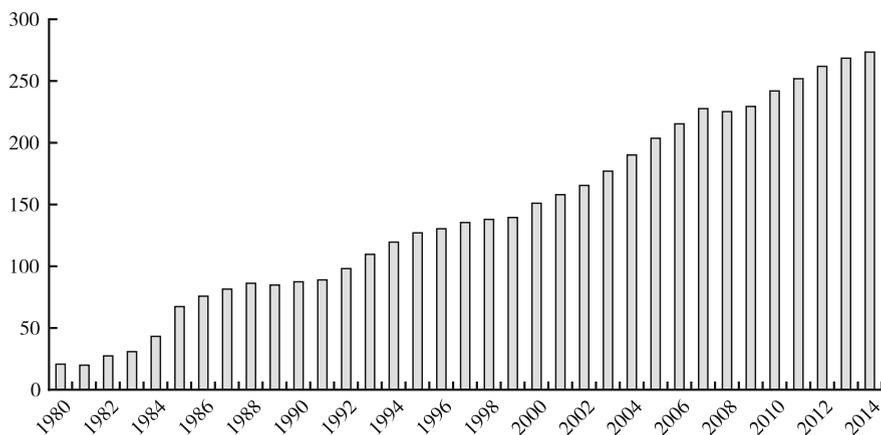
### **2.2.2.3 The Policy Allowing Migration of Whole Families**

The stability of rural migrants finding employment outside of their homes has gradually augmented as the number of years one can work grows. The more stable employment is for migrants, the more likely it is that they will bring their families with them. To meet the demands of these rural migrants, the central government has demanded that local governments in places where laborers migrate provide opportunities for compulsory education to the children of migrants. Table 2.2

**Table 2.1** Migration of rural laborers over the years

Year	Absolute			Year	Absolute		
	# of migrant laborers (mn)	% of total rural population	Annual growth		# of migrant laborers (mn)	% of total rural population	Annual growth
1980	20.28	6.37	3.84	1998	138.058	29.73	2.06
1981	19.94	6.10	-1.68	1999	139.847	29.82	1.30
1982	27.14	8.01	36.11	2000	151.646	31.62	8.44
1983	30.447	8.78	12.18	2001	157.780	32.71	4.04
1984	42.826	11.91	40.66	2002	165.360	34.08	4.8
1985	67.136	18.11	56.76	2003	177.110	36.17	7.11
1986	75.219	19.80	12.04	2004	190.990	38.43	7.84
1987	81.304	20.85	8.09	2005	204.120	40.51	6.43
1988	86.110	21.49	5.91	2006	215.584	42.3	5.62
1989	84.983	20.76	-1.31	2007	227.950	44.3	5.74
1990	86.731	20.65	2.06	2008	225.42	43.3	-1.11
1991	89.062	20.67	2.69	2009	229.78	43.7	1.93
1992	97.646	22.29	9.64	2010	242.23	45.5	5.42
1993	109.975	24.85	12.63	2011	252.78	47.1	4.36
1994	119.640	26.79	8.79	2012	262.61	48.8	3.89
1995	127.073	28.21	6.21	2013	268.94	49.8	2.41
1996	130.276	28.77	2.52	2014	273.95	50.5	1.86
1997	135.268	29.43	3.83				

*Data source* National Bureau of Statistics, *China Statistical Yearbook* (several years); and Ministry of Agriculture, *China Agricultural Development Report* (several years)

**Fig. 2.1** Rural laborer migration figures over the years (million)

**Table 2.2** Percentages of rural migrant laborers to total rural laborers over the years

	Total # of rural laborers (mn)	Migrant laborers		Total # of migrants	
		Total # of migrant laborers (mn)	% of total laborers	Leaving home with entire family (mn)	% of total
2008	224.52	140.41	62.5	28.59	12.7
2009	229.78	145.33	63.2	29.66	12.9
2010	242.23	153.35	63.3	30.71	12.7
2011	252.78	158.63	62.8	32.79	13.0
2012	262.61	163.36	62.2	33.75	12.9
2013	268.94	166.10	61.8	35.25	13.1
2104	273.95	168.21	61.3	36.75	13.4

*Data source* National Bureau of Statistics, migrant laborer surveys conducted over the years

demonstrates that the number of migrants leaving with their entire families grew from 28.59 million in 2008 to 35.25 million in 2013, that latter figure equaling the total amount of rural migrants in 1983.

## 2.2.3 Reforms to Rural Capital Markets

### 2.2.3.1 Progress of Reforms

The objective of reforms to rural capital markets is to establish a rural financial system that organically combines commercial financing, policy-based financing, and cooperative financing, on a foundation of cooperative financing. Officials have adopted the following measures to achieve this objective.

One, restoration of rural financial institutions. In December 1978, the third plenum of the 11th Communist Party of China (CCP) National Congress passed the “CCP Central Resolutions on Several Issues Regarding Accelerating Rural Development (draft),” which called for “restoring the Agricultural Bank of China and making great efforts to develop rural credit enterprises.” The Agricultural Bank of China (ABC) was thus restored for the third time on March 13, 1979. As compared with previous incarnations of the bank, the scope of oversight over fiscal allocations to the new bank was greatly reduced, while the scope of its credit business was greatly expanded, making it a comprehensive bank responsible for rural financing.

Two, separation of policy-based financing from commercial financing. To this end, the Agricultural Development Bank of China (ADBC) was founded in April 1994. The new bank’s major duties were to raise capital for the issuance of agricultural policy-based loans on a foundation of state credit, assume responsibility for state-mandated agricultural policy-based financing, and appropriate agricultural assistance funds on behalf of the state treasury. The bank was specifically

responsible for contract purchasing of state grain, cotton, and edible oil reserves as well as other agricultural products, comprehensive agricultural development, policy-based loans for poverty alleviation and other dedicated loan projects, appropriations of agricultural assistance funds on behalf of the treasury as well as oversight of their usage. In May 1998, the ADBC also assumed responsibility for the supply and management of capital for purchasing monopolized agricultural products and by-products in order to assist in nationwide grain circulation system reforms. Responsibility for comprehensive agricultural development, including mountainous regions, water resources, forests, and fields, as well as the issuance of dedicated loans such as poverty alleviation loans with suspended interest, and the issuance of policy-based loans such as those made to grain and cotton processors and accompanying business services was handed over to the ABC. All other policy-based agricultural assistance activities were put under administration of rural credit cooperatives.

Three, separating rural commercial financing from cooperative financing. The direction of reform was for rural credit cooperatives to become cooperative financial organizations and for the ABC to become a commercial bank; rural credit cooperatives and the ABC shirked off their former direct administrative subordination.

Per state policy, rural credit cooperatives could choose to become one of the following: rural commercial banks, rural cooperative banks, incorporated county-level supply and marketing cooperatives, or dual county-and-township-level corporations. The classification chosen by county-level supply and marketing cooperatives was determined by grass-roots credit cooperative delegates on the basis of actual circumstances. It was made mandatory that at least 50% of all loans from such organizations be made to cooperative members, and that all linkages to the ABC be severed by the end of the year. Business management was undertaken by county-level supply and marketing cooperatives, and financial oversight undertaken by the People's Bank of China. Rural cooperative banks were capitalized by legal investments from the treasury of the county (or county-level city) in which they were located, from all manner of companies, and from local residents, and the grade-one corporate system was applied. Their primary loan targets were agricultural service providers, agricultural product processors, and all other kinds of rural enterprises. Fixed asset loans could not exceed 30% of total loans. Although the central government initially wished to turn rural credit cooperatives into cooperative financial organizations, it was clear that they were becoming increasingly commercial and less cooperative over time. For example, most credit cooperatives in developed regions were reformed into rural commercial banks.

Four, establishment of a diversified rural finance system. Central Document Number One of 2004 proposed that rural financial institutions be established to serve the "three rurals"—agriculture, rural areas, and farmers—and an increase in the range of fluctuations on loan interest. Central Document Number One of 2005 then proposed such measures as relaxing entry conditions for rural financial institutions and establishing petty loan organizations founded by natural persons or enterprises closer to rural people and rural needs. Central Document Number One

of 2006 then proposed such measures as returning postal reserve capital to the countryside, guiding rural households to develop capital mutual aid organizations, encouraging the establishment of community financing bodies under different ownership structures at the county level, permitting private capital and foreign capital in the purchasing of shares, and standardizing private loans.

### **2.2.3.2 Standardizing Private Loans and Developing Non-profit Financing**

One, guiding financing within rural communities. Central Document Number One of 1984 clearly pointed out the “allowance of free or organized circulation of the capital of rural citizens or collectives.” This was the legal basis for fundraising activities within rural communities. Central Document Number One of 1985 then called for “loosening up policies on rural financing and increasing the effectiveness of capital circulation.” Central Document Number Five of 1987 then noted: “Some township and village cooperative economic organizations or enterprises have collectively established cooperative funds, and some localities have established trust and investment corporations. These credit activities conform to the demands of the development of commercial production and are beneficial to concentrating idle capital from society and alleviating capital supply shortages of the ABC and credit cooperatives; in principle, we should affirm and support them.” In November 1991, the Resolutions of the eighth plenary session of the 13th CCP Central Committee required that all local governments continue to establish rural cooperative funds. In 1996, officials began to clean up and reorganize rural cooperative funds to address issues of illegal financing such as offering nominally high interest rates to attract deposits and the issuing of loans using capital thus raised. The policy specifically called for: merging rural cooperative funds with relatively large amounts of financing activities and loan activities into existing agricultural credit cooperatives or reorganizing them into new rural credit cooperatives after capital verification, and forbidding the attraction of resident deposits by floating shares to them for any fund not willing to be merged into an existing credit cooperative or to be made into a new one. All those without prerequisites for being converted into rural credit cooperatives were made into true cooperative funds. By the end of 2000, all rural cooperative funds were either merged into local credit cooperatives or liquidated and shut down by local governments.

Two, establishment of standards for private loans. There were two government policies regarding private loans. The first severely attacked illegally established financing bodies, the illegal attraction or attraction by ruse of deposits from the general public, and illegal fundraising activities. Financing bodies were not allowed to open accounts, handle accounting, or provide loans for illegal financing bodies or illegal financing activities; those in violation were punished in accordance with the law. The second laid out strict standards for private loan behavior. All capital lent out had to be legally earned and fully owned by the lender. It was strictly forbidden to take money from others to flip to somebody else as a loan. Interest rates were set

through consultation between both parties, but interest rates could not be more than five times those established over the same period for similar grades of loans established for financial institutions by the People's Bank of China (excluding fluctuations). All loans exceeding that standard were considered usurious.

Three, support for non-profit petty loans. Officials first allowed and encouraged the development of non-profit petty loans. Petty loans came into practice in China in the mid-1990s. Government organs overseeing financial affairs did not formally approve such financial activities, but out of consideration of the importance of the non-profit nature and effectiveness at poverty alleviation of petty loans, as well as the necessity of developing social poverty alleviation, government officials never took their eyes off of these activities. They further wrote the line "we must summarize and promote the effective method of bringing poverty alleviation capital to households such as petty loans" into the "CCP Central Resolutions on Several Issues Regarding Agriculture and Rural Work" passed in 1998 by the third plenary session of the 15th CCP Central Committee. They then pushed credit cooperatives to develop petty loan services. In July 1999, the People's Bank of China designed the management method of "one loan document per household" and the operational method of "verifying once, issuing loans wherever they are used, controlling balances, and turnover usage" for petty loans to rural households. In January 2000, the People's Bank of China adopted the risk management technique of "mutual guaranteeing of many customers, deposits at set intervals, and loan repayments in stages" for petty loans. Under this technique, the amount of single loans was, in principle, not to exceed the annual income of the borrowing household, and loan terms were not to exceed one year. To encourage credit cooperatives to develop these loans, the People's Bank of China provided agricultural-supporting refinancing capital at interest rates between 2 and 3% while also requiring that rural credit cooperatives issue this refinancing capital to rural citizens in the form of petty loans to be used for agricultural production. They then pushed the postal reserve system to issue petty loans. In December 2005, the China Banking Regulatory Commission (CBRC) established the three provinces of Fujian, Hubei, and Shaanxi as pilots for the issuance of postal reserve petty pledge loans with fixed-interval deposits, in order to establish channels for the return of postal reserves to the countryside, to alleviate pressure from outflows of rural capital, and to smash the monopoly on the loan market of rural credit cooperatives. In December 2006, the State Council authorized the Postal Reserve Bank to issue petty loans everywhere in the nation.

### **2.2.3.3 Rural Financial Policies Directed at Marketization**

One, relaxing controls on interest rates. Formal financial institutions in China had long been making reform explorations into relaxing controls on interest rates. So interest rates on loans issued by financial institutions below the county level had long fluctuated more than those of other financial institutions. In January 2004, the People's Bank of China raised the upper limit on interest rate fluctuations for loans

issued by rural credit cooperatives from 2.5 to three times the benchmark rate. In October 2004, the central bank raised the upper limit on interest rate fluctuation on loans issued by urban-rural credit cooperatives to 3.3 times the benchmark. The bottom limit remained at 1.9 times the benchmark rate.

Two, relaxing of entry conditions for financial institutions in rural areas. In December 2006, the CBRC decided to launch pilots in relaxing entry conditions for financial institutions in rural areas in the five provinces and one autonomous region of Sichuan, Inner Mongolia, Jilin, Guizhou, Gansu, and Qinghai. On March 1, 2007, China's first village-and-town bank, the Sichuan YilongHuimin Village-and-Town Bank and Sichuan YilongHuimin Lending Co., Ltd., opened for business. The opening of village-and-town banks, lending companies, and rural capital mutual aid societies in the countryside symbolized the complete opening of rural financial markets in China and effectively ameliorated financial services in the countryside.

Three, development of private commercial petty loan institutions. In 2005, the central bank launched pilots for the development of commercial petty loan bodies in Pingyao, Shanxi; Jiangkou, Guizhou; Guangyuan, Sichuan; Ordos, Inner Mongolia; and Hu County, Shaanxi. On December 27, 2005, the two fully-privately-capitalized commercial petty loan companies Jinyuantai and Rishenglong were allowed to open in Pingyao. In 2006, five other petty loan companies were allowed to open in Sichuan, Guizhou, Shaanxi, and Inner Mongolia. Their upper limit on interest rates was five times the central bank's benchmark rate.

#### **2.2.3.4 Reforms to Formal Rural Financial Institutions**

China's formal rural financial institutions include rural credit cooperatives, the ABC, and the ADBC.

Reforms to formal rural financial institutions made progress in the following four areas. First, there was a transition away from solely supporting grain production toward supporting comprehensive agricultural development, including forestry, husbandry, agricultural by-products, and fisheries. Beginning in 1978, the ABC began offering a great measure of loan support to multiple kinds of rural operations, without slacking support for grain production, in order to support adjustments to the agricultural structure. Second, primary loan recipients were no longer collectives but individual rural households. At the end of 1986, the ABC and rural credit cooperatives collectively issued a total of 53.7 billion yuan in agricultural loans, over 60% of which to rural households. Third, the rise of town and village enterprises (TVEs) was supported. Total loans issued by the ABC and rural credit cooperatives to TVEs rose from under 3.3 billion yuan in 1978 to 84.7 billion yuan in 1988. Fourth, the circulation of rural commodities was supported. The total of commercial loans issued by the ABC rose from over 2.60 billion yuan in 1978 to over 230 billion at the end of 1990.

One, reforms to the ABC. In 1979, the ABC was the government department in charge of rural finance. It was effectively a direct subordinate government organ to the State Council, with its own subordinate branches in local governments. In 1984, the ABC was removed from the ranks of other government bodies and made an enterprise, still directly subordinate to the State Council, but it still managed institutional arrangements, personnel decisions, and loan balances of rural credit cooperatives with authorization from the government. Now an enterprise, the ABC underwent enterprise-directed reforms. The first was the reform of its credit management system of “unified deposits and loans,” meaning that all deposits and loans in the country were managed by the People’s Bank of China alone. In 1980, the ABC implemented a policy of complete responsibility over its own affairs by linking loans with deposits.

This new system of “complete responsibility” was, however, limited to the deposits and loans of commune-and-production-team collectives and individuals, and it was thus referred to as the “little complete responsibility” system. In 1981, the system was expanded to include all lending business, now called “big complete responsibility.” In order to benefit maximally from the drive toward increased deposits and increased loans, the system of “contracting once a year” was changed into a fixed big responsibility system that was “fixed for three years.” The second was the implementation of a system for retaining profits and responsibility for operations. In 1983, the ABC broke through the fiscal system of “unified deposits and loans” and established a system for retaining profits in order to incentivize all subordinate branches to work harder. The third was the implementation of a capital management responsibility system of “unified plans, graded management, lending out no more than total deposits, and autonomous operations.” Officials changed vertical funds regulation into a synthesis of vertical and horizontal funds regulation. The fourth was the bank’s taking the lead among state-owned financial institutions in implementing the contracting system. The concrete method for pushing this reform in 1988 was that the ABC pledged to pay 2.45 billion yuan in taxes and profits to the central government, with anything earned in excess of that figure to be divided at the ratio of 10% for the treasury and 90% for the ABC. Per government demands, the bank handed central bank reserves and pooling funds over to the central government and bought treasury and construction bonds stipulated by the state. The bank carried out lending plans that came in the form of directives, completing such indices as deposit growth rates, loan recovery rates, the utilization rate of credit funds, comprehensive fee rates, and capital loss rates. All retained capital on portions not meeting pre-set indicators were deducted at a fixed ratio. In order to reform itself into a commercial bank, the ABC changed its “four-tiered management (bank headquarters—branches—central sub-branches—sub-branches) and single-tiered operations model (sub-branches)” into a “four-tiered operations” model in 1994. Bank officials established the operations department in bank headquarters to handle deposit and accounting services for large enterprises and groups or economic consortiums. Officials implemented a management system of the debt-to-assets ratios at the level of managing credit capital. They also established a risk management system for credit assets and founded a loan approval

committee. Finally, they implemented separation between loan issuance and loan approvals, established a risk compensation system, and a system of allowance for doubtful accounts.

Two, reforms to rural credit cooperatives. Reforms to rural credit cooperatives proceeded apace with the goal of restoring their natures as cooperative financial institutions. These reforms were divided into three stages.

In the first stage, the cooperative financing nature of these institutions was restored. In the early 1990s, after establishment of the socialist market economy, the following reform measures were enacted upon rural credit cooperatives in accordance with the demands of developing the market economy. The first was the work of “cleaning up” existing shares—allowing some shareholders meeting conditions to cash out, allowing others to convert their shares into shares of the new company, and the conversion of all other shares into “accounts payable”—and recapitalizing through the issuance of new shares. The second included such measures as implementing increased deposits and increased loans, floating interest rates, debt-to-assets ratio management and so on. The third included the establishment of a congress of cooperative members and a regulatory commission, strengthening democratic management, improving internal job responsibility systems and operations mechanisms, eliminating “iron rice bowl” positions, and bringing about egalitarianism in allocations. The fourth was the establishment of county-level supply and marketing cooperatives for rural credit cooperatives. These were made into the management centers, capital centers, accounting centers, and information service centers of credit cooperatives. The fifth was the establishment of sound institutions at all levels. Management work was institutionalized and standardized. There were five issues in this stage of reforms. The first was that management systems had not yet been completely sorted out, and an effective system for organization and management had not yet been formed. The second was that many administrative measures but few economic and legal measures had been used in the reforms. The third was that credit cooperatives were still subject to control by the ABC and higher-level credit cooperatives, making it difficult to enforce job responsibilities on the part of boards of directors and supervisors. The fourth was that enforcement of credit management laws was lax, and mechanisms to limit lending risks not sound, so many credit cooperatives were still losing money. The fifth was that accounting channels for rural credit cooperatives were obstructed, restricting the development of their business.

In the second stage, reforms were enacted on the operations and management system. The following measures were taken in this stage. First, once original shares were “cleaned up,” new shares were sold to individual rural citizens, small businesses, and rural collective enterprises in order to recapitalize the institutions. Second, the People’s Bank of China established cooperative finance regulatory bodies and strengthened oversight of rural credit cooperatives. Third, officials founded city (or prefectural-level city) credit cooperative associations to bring about high-level organization of such. Fourth, officials launched pilots in rural credit cooperative work. There were four primary areas of reforms: (1) the establishment of provincial-level credit cooperative associations and reorganization of the credit

cooperative organizational system; (2) strengthening of the financial sustainability of credit cooperatives to make them better suited to rural economic development; (3) the reorganization of credit cooperatives in developed areas into rural commercial banks; (4) exploration into ownership systems and corporate structures suitable for credit cooperatives, as well as self-limitations on rural credit cooperatives. Marked reform progress made during this stage was as follows: A major step forward, not a step backward, was taken in the adoption of the shareholding system and the reorganization of credit cooperatives in developed areas into rural commercial banks, and the cooperative nature of these institutions was restored.

In the third stage, innovations were made to the operations and management system. In June 2003, eight provinces (or cities under direct command of the central government), including Zhejiang, were chosen as rural credit cooperative pilots for reforms to management systems and ownership institutions. Specific measures taken include the following. (1) Credit cooperatives were allowed to autonomously select their form of ownership structure, including shareholding systems, shareholding cooperative ownership, straight-up cooperative ownership, and so on, per the principles of shareholding structure diversification and diversified shareholding entities, as well as actual conditions. (2) The central government began paying interest subsidies to protect reserve values of credit cooperatives losing money. The government began exempting or reducing by half corporate income taxes and levying a business tax of only 3% on credit cooperatives in the western region and in pilot areas. The government offered capital support to credit cooperatives in pilot areas through refinancing loans or the issuance of central bank bills and authorized interest rate flexibility in regions with vigorous private lending scenes. In 2004, these reforms to rural credit cooperatives were extended to all regions of the country except Hainan and Tibet.

The course of reforms to rural credit cooperatives went as follows. The costs of reforms to these cooperatives were compensated, and their historical burden was lifted. Shareholding reforms brought about increased investment through purchasing shares, abundant capitalization, clear ownership structures, and increased capacity of credit to withstand risk. Provincial credit cooperative associations were founded. There are still three issues we must resolve: the issue of excessive concentration of power and control by insiders, the issue of incentive and restriction mechanisms on the management stratum of rural credit cooperatives, and the issue of inappropriate administrative interference and management fees on the part of provincial credit cooperative associations.

Three, reforms to the Agricultural Development Bank of China. When first founded in 1994, the ADBC was a policy-based financial institution directly subordinate to the State Council with a vertical leadership management structure. Its primary duties were to oversee policy-based agricultural financing and fiscal agricultural support allocations. Most of its capital came from the issuance of financial bonds to financial institutions, treasury funds intended for agricultural support, and the deposits of enterprises taking out agricultural policy-based loans. The ADBC audited its own accounts and operated autonomously under a corporate governance structure per the principle of neither earning nor losing money. Its activities were

guided and supervised by the People's Bank of China. Primarily, it handled state-mandated dedicated reserves, transfer and sale loans, wholesale loans, and loans issued to enterprises processing grain, edible oil, cotton, and jute fulfilling policy-dictated duties, for major agricultural products and by products such as grain, cotton, oil crops, pork, sugar, and so on, with interest discounted by the Ministry of Finance, funds allocated by the People's Bank of China, and projects determined by the State Council. It also issued loans for poverty alleviation, comprehensive agricultural development, small infrastructure projects, and technological transformation projects, as well as agricultural support allocations and the issuance of bonds from the central and provincial governments. In the past two years, the ADBC has also become an agent for multiple kinds of insurance and has developed loans for grain and oil seeds and loans for small agricultural enterprises. The bank has consummated mechanisms for the review and approval of loans, such as its loan approval committee and has established a more independent, authoritative, and effective internal auditing system. It has launched a pilot into a system of placing delegates in charge of the financial committee. It has expanded autonomous operations and commercial activities in which it assumes responsibility for risks, while fully complying with government directives to issue policy-nature loans.

### **2.2.3.5 Informal Financing in Rural China**

Informal financial institutions in rural China can be divided into two categories: traditional rural informal financing and new rural informal financing. The traditional category encompasses four sub-categories: free lending by individuals, small-loan associations, underground private banks, and money backs. Free lending by individuals takes place between family members, friends, and neighbors. Loans amounts are small and terms short. Some such loans are made by strictly oral contract, and some are made by written contract. Most such loans are made without consideration of profits, with interest earned used only to offset some living expenses. Such loans to people other than family members, friends, and neighbors are often conducted in pursuit of profits, and the relatively larger amount of interest payments are used mostly to invest in production. Interest rates on these loans are generally between four and five times those of banks for similar sized loans, and sometimes even higher. Small-loan associations are temporary financial organizations established to achieve ends of mutual aid and cooperation that combine the collection of deposits and the issuance of loans in a single body, and are generally autonomously established by non-professionals and generally held together by bonds of kinship, friendship, or neighborhood. These associations are temporary and can be divided into "monthly associations," "seasonal associations," "semi-annual associations," and "annual associations." They are further divided into "rotating," "determined by shooting the dice," and "drawing lots," to see which member should be the recipient of the new term's loan. Underground private banks are institutionalized or semi-institutionalized financial organizations that operate for profits. Most evolve out of small-loan associations, with the difference between the

two being that they attract more deposits from locals and conduct more transactions. Money backs are go-betweens who make arrangements between lenders and borrowers and earn commissions on transactions as well as information fees.

New rural informal financial institutions include rural mutual aid saving societies, rural cooperative funds, rural financial service companies, and so on. First, let's address how new rural informal financial institutions arise. One prominent issue that appeared after reforms to the agricultural micro-base was: capital accumulated by collective economic organizations sat idle for long periods of time, while rural citizens in need of capital were unable to secure loans from credit cooperatives. To resolve this issue, some communities allowed rural households to use their collective shares to access a portion of collective capital (meaning they could receive their portion of dividends but not cash out their shares). These funds were used to establish cooperative funds, which made attempts at capital circulation within the community. By 1988, 80% of townships and towns in Jiangsu, 40% in Hubei, and 28% in Liaoning had established rural cooperative funds, having raised, respectively, 800, 280, and 260 million yuan. Of those three, Liaoning paid out a total of 250 million yuan to individual rural citizens and TVEs. Second, let's address the effects of new rural informal financial institutions. First, they resolved long-standing chaos in collective asset management and issues of inappropriate funds usage, while solidifying and shoring up the collective economy. Second, they expanded rural fundraising channels, alleviated supply and demand imbalances in rural capital, and promoted the growth of both agriculture and the rural economy. Third, they deepened reforms to the rural financial system and drove the formation of a new order in rural finance, with more forms and more levels. Fourth, they suppressed rural usury and drove development of poverty alleviation work and increases to rural incomes. Third, let's address the problems associated with new rural informal financial institutions. The first is the prominence of administrative interference. Although financial organizations within the countryside come in the form of shareholding cooperatives, most have become subordinate to administrative organizations at the township or village level, making it difficult for them to give ample autonomy or benefit to members. Second, the narrow scope of their allowable activities limits their ability to seek opportunities for greater profitability; they have few sources of capital and poor ability to accumulate. Most profit allocations are done per the "two-eight system," meaning that 80% goes to capital owners and 20% goes to daily costs, welfare costs, risk funds, and development funds; only a very limited amount goes to true business development. Third, there is a lack of necessary laws and regulations for capital operations.

### **2.2.3.6 Scale of China's Rural Finance Market**

One, the scale of the formal financial market. By the end of 2005, capital in China's formal rural financial institutions totaled 3.7206 trillion yuan, of which 2.2008 trillion had been issued as loans (10.9% of nationwide loans issued by financial institutions), an increase of 807 billion yuan over 2002, or a 57.9% growth. Total

debt of said institutions was 3.5553 trillion yuan, of which deposits totaled 3.2626 trillion yuan (10.8% of total nationwide deposits in financial institutions), an increase of 1.2751 trillion yuan over the end of 2002, an increase of 64.2%. Owners' equity totaled 165.3 billion yuan, an increase of 192.7 billion yuan over the end of 2002. The People's Bank of China had an accumulated total of agricultural supporting refinancing loans of 1.0224 trillion yuan and an ending balance of 59.7 billion yuan, of which over 90% consisted of loans issued to rural households. All rural cooperative financial institutions (including rural credit cooperatives, rural commercial banks, and rural cooperative banks) had issued a total of 1.0071 trillion yuan in agricultural loans, an increase of 449.2 billion yuan over the end of 2002, a growth of 80.5%, higher than the average growth rate of 22.6% for other loan categories over the same period. Of those, a total of 798.3 billion yuan of loans had been issued to rural households, supporting a total of over 71 million rural households. About 60% of rural households applying for loans were granted them. If one includes those rural households who had taken out loans in the past but had no loan balances at the time, the coverage of loan issuance by rural credit cooperatives to rural households was then larger. The amount of poverty-alleviation interest-discounted loans was small. Per statistics from the ABC, by the end of June 2004, the total of petty poverty-alleviation interest-discounted loans made to rural households was 38.1 billion yuan, affecting a total of 11.75 million rural households.

The total of agricultural loans issued by formal rural financial institutions in China grew from 49.70 billion yuan in 1994 to 2.1055 trillion yuan in 2004, a 5.4-fold increase. Of those, short-term agricultural loans totaled 984.3 billion yuan, mid to long-term loans totaled 368.9 billion yuan, and loans made to purchase agricultural products and by-products totaled 652.3 billion yuan, account for, respectively, 46.7, 17.5, and 35.7% of total agricultural loans. The total of short-term loans issued by formal institutions rose and fell, but the proportion of agricultural loans, TVE loans, and individual or small business loans to total short-term loans consistently grew (Table 2.3).

Two, the scale of the informal rural financial market. Per capita rural private lending in China grew from 25.40 yuan in 1984 to 56.64 yuan in 1990, an average annual growth of 14.3%. The nationwide scale of private lending among rural households was between 50 and 70 billion yuan, making it the dominant force in rural lending. It was difficult for formal financial institutions to meet the vigorous demand for rural financing in China. This is an important reason for the development of informal financing and for the dominant role that informal financing came to play in the countryside. Interest rates were high on private loans in regions with highly developed commodity economies. In regions with poorly developed commodity economies, on the other hand, most private loans were made at low or no interest. In economically developed regions, most private loans were used in highly profitable manufacturing operations, but in economically backward regions, most private loans were made to meet urgent life needs or to fund ordinary manufacturing activities. From 1995 to 1999, private loans accounted for about 70% of all rural lending. Zhu Shouyin, the International Fund for Agricultural Development,

**Table 2.3** Amounts of various agricultural loans issued by Chinese Financial Institutions, *Unit* billion yuan

Year	Agricultural loans (1)	Loans to purchase ag. products and by-products (2)	Other agricultural loans (3)	Short-term ag. loans (4)	Long and mid-term ag. loans (5)
1990	355.966	231.557	124.409	–	–
1991	453.540	297.303	156.237	–	–
1992	517.841	319.126	198.715	–	–
1993	596.128	356.394	239.734	–	–
1994	496.987	382.602	114.385	114.385	–
1995	698.985	544.506	154.479	154.479	–
1996	878.989	687.077	191.912	191.912	–
1997	1304.291	850.174	454.117	331.464	122.653
1998	1364.515	765.722	598.794	444.424	154.370
1999	1515.892	834.943	680.949	479.239	201.710
2000	1551.082	806.433	744.649	488.899	255.750
2001	1664.244	798.423	865.821	571.148	294.673
2002	1798.154	781.819	1016.335	688.458	327.877
2003	1925.068	728.286	1196.782	841.135	355.647
2004	2105.496	752.316	1353.179	984.311	368.868

Note (1) = (2) + (3); (3) = (4) + (5)

He Guangwen, and others all came to similar conclusions. Loans taken out for life needs accounted for 47.75% of total loans, and 53.29% of all rural private loans were made at no interest. The proportion of loans taken out by rural households from formal financial institutions is increasing, while the proportion of private lending is decreasing (Table 2.4).

In 2003, the capital scale of formal financial institutions was nearly 800 billion yuan. There are four characteristics of private financing. The first is that such lending activities are semi-overt. The second is that there are very few breaches of contract. The third is that a higher proportion of such lending is of a production nature. The fourth is that interest rates are markedly higher.

### 2.2.3.7 Overall Assessment of Reforms to China's Rural Finance System and Development Thereof

Reforms to China's rural finance system since Reform and Opening have conformed to the demands of deepening financing, have conformed to the demands of transforming the national economy, and have conformed to the demands of the hundreds of millions of Chinese rural citizens for economic development and improvement of life.

**Table 2.4** Rural household loan capital sources, 1995–2005 (%)

	Loans from banks or credit cooperatives	Private lending	Other
1995	24.23	67.5	8.02
1996	25.42	69.27	5.31
1997	23.94	70.38	5.68
1998	20.65	74.29	5.06
1999	24.43	69.41	6.16
2000	29.44	68.44	2.12
2001	29.21	68.7	2.09
2002	26.09	71.83	2.08
2003	31.78	63.94	4.28
2004	30.72	62.98	6.3
2005	34.2	58.37	7.43

Following the separation of cooperative finance from commercial finance, the separation of policy-based finance from commercial finance, the relaxing of controls on interest rates, the easing of entry conditions for rural financial institutions, and the continuous innovation in rural financial institutions, financial tools, and financial products, the financial system established by the government with coordination and division of duties between cooperative finance, commercial finance, and policy-based finance, with diversified investment sources, of many kinds, of broad coverage, of flexible administration, and of effective service, is now currently forming.

Rural Chinese citizens have a great deal more opportunity to benefit from financial services, and the coverage of rural financial services is currently expanding and deepening greatly. However, a portion of said credit capital has not played a true role in supporting agriculture. In order to resolve these issues as quickly as possible, we must continue to deepen reforms in the field of rural finance and further amplify financial reforms.

### 2.3 Reforms to the Agricultural Land System

Before Reform and Opening, China's rural collective land ownership system was "three-tiered ownership with the production team as the foundation." The "three-tier" nature meant some of the land in a given people's commune belonged to the commune, some to the production brigade, and some to the production team. "Production team as the foundation" meant the vast majority of rural land was owned by production teams, which were responsible for management and operation of that land. A small portion of land belonged to communes and production brigades, which were likewise responsible for management and operation thereof.

### ***2.3.1 Progress of Reforms to the Agricultural Land System***

#### **2.3.1.1 Promoting Reforms to Allow Farmers the Right to Operate Contracted Land**

By the end of 1983, 99.5% of all production teams in the nation had implemented the Household Responsibility System, with 97.8% of those implementing the system of full responsibility for production. The primary source of income for farmers shifted from the collective toward the household as reforms to the agricultural production and operation system were promoted.

#### **2.3.1.2 Issuing Policies to Uphold the Rights of Farmers to Contract and Operate Land**

After the success of the Household Responsibility System, the state took a series of measures to protect rural citizens' rights to operate the land they contract. First, officials extended the terms for which land could be contracted. Before the end of the first term of land contracting, the central government clearly announced that land contracting terms were to be extended by 30 years. This made rights to operate contracted land for rural citizens even more stable in the long term. Second, they issued certificates of rights to operate contracted land to rural households to limit the ability of collective economic organizations to redistribute land at will. Once the process for redistributing land had become stricter, the rights of rural citizens to operate contracted land became more stable. Third, they rescinded agricultural planting plans, giving increased autonomy to rural citizens to operate their land as they saw fit. Fourth, they upheld the rights of rural citizens to transfer land. During the contracting term, rural households have the legal right to decide whether to transfer land, and by what process if so. No organization or individual has the right to coerce rural households into transferring land or to obstruct them from transferring land if that is their wish. Transfers of contracted farmland thus became increasingly marketized. Fifth, the government made it clear that "increased mouths do not mean increased land, nor do decreased mouths mean decreases in land" to prevent local village and township leaders from changing land contracts at will or distorting the wording of the land contracting policy: "unchanging for 30 years."

#### **2.3.1.3 Improving Laws to Safeguard Rural Citizens' Rights to Operate Contracted Land**

In the beginning, there were issues of disunity of terms for land contracting and unclear obligations accompanying land contracting rights. This was the root cause of many disputes over contracted land. To address these issues, the central government in 1998 issued the "Land Management Law," which clearly stipulated that

“the right to contract and operate land is protected by law.” The “Rural Land Contracting Law,” which went into effect on March 1, 2003, made stringent stipulations for land redistribution, the rights and obligations of contracting land, transfers of contracted land, terms for land contracting, and other areas. This made the right to contract and operate land a right guaranteed by law and allocated directly to rural citizens. The “Property Law” that went into effect on October 1, 2007, clearly stipulated the usufruct and operation rights of contracted land. That means that the rights on farmland contracted out by collective economic organizations, whether it be contracted to a family, obtained via bidding, auction, open negotiations, or any other means, or whether the land is contracted by a collective under the Household Responsibility System, usufruct rights to all such land are now legally protected. Thus the right to operate contracted land has been elevated to a property right now protected by the state’s “Property Law.”

### ***2.3.2 Developing a Rural Land Market***

Shortly after Reform and Opening, the government allowed rural citizens both the right to contract operations rights for land and also the right to transfer those rights to others. However, land transfers proceeded slowly as rural labor transitioned sluggishly. By the end of 1984, only 2.7% of rural households had contracted out part of their farmland, and only 0.7% of all farmland had been transferred by contract. A sampling survey conducted in 1993 indicated that 4.733 million rural households, 2.3% of total rural households, had contracted for a total of 11.61 million  $\mu$  of farmland, 2.9% of the national total.<sup>3</sup> As the process whereby rural laborers concentrate in urban centers or rural non-agricultural industries has accelerated, a higher percentage of farmland has come to be contracted out. In recent years, the amount of rural land contracted in China has steadily increased. In 2008, the total amount of rural land contracted out broke the 100 million  $\mu$  mark, up again to 270 million  $\mu$ , or 21.5% of the national total, in 2012. That number rose again to 340 million  $\mu$ , 26% of the national total, in 2013, and had reached 380 million  $\mu$ , or 28.8% of the national total, by the end of June 2014 (Table 2.5).

The process of economic development is one whereby the number of rural households dependent upon farmland for their living grows increasingly smaller. As upgrades are made to the employment structure, the opportunity costs of rejecting agriculture for rural households engaged in multiple enterprises will grow smaller as the share of overall household income from agriculture decreases. Overall incomes of leading rural households are determined primarily by the scale of land operations and not by net income per unit of area of land, and so their ability to pay rent on farmland will increase as the scale of land they operate grows. It is, thus, objectively inevitable that, given the influence of these two trends, more farmland

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<sup>3</sup>Zhang Hongyu (2002).

**Table 2.5** Changes to area of contracted land, *Unit* 100 million  $\mu$ 

	1993	2007	2008	2009	2010	2011	2012	2013	2014
Area	0.12	0.6	1.09	1.51	1.87	2.28	2.78	3.41	3.80
% of total	2.3	5.2	8.9	12.0	14.6	17.8	21.5	26.0	28.8

will be concentrated in the hands of leading rural households. The more stable the rights of rural households to contract land, the easier it will be for land to be transferred, and vice versa. This is the primary reason for emphasizing the stability of land contracting rights.

The advantages of land transfers are the driving of suitably scaled agricultural operations and the development of leading rural households, both of which drive up the overall efficiency of agricultural production operations. Land transfers are beneficial to the centralization of land ownership, thereby reducing the area occupied by roads and paths between farm fields and enabling some abandoned land to be used. The integration of such land can increase total land use efficiency by about 5%. Scaled land operations are also beneficial to increasing the negotiating power of rural households in market transactions, thereby bringing about a certain degree of cost reductions and revenue increases. The primary effects of concentrating grain planting in the hands of a few major households through land transfers are to increase the precision and economic efficiency of investments, to reduce the risks of planting non-grain crops, and to reduce the costs of grain production. Such concentration does not greatly increase grain yields. The specific tasks regarding land transfers are as follows.

One, the scale of farmland operations must be suitable to the level of economic development. Scaled agricultural operations will conform more to reality as gradual advances are made in industry structure upgrading. Agricultural scale is appropriate if the per capita income of leading rural households is not less than the per capita incomes of rural households engaged in multiple industries.

Two, leading rural households should become China's primary agricultural entities. If ever resident incomes reach or exceed the urban-rural resident average income standard of 3000 yuan, or if a smaller amount of leading rural households become the primary force in agriculture determining the country's agricultural competitiveness, we should then adopt policies to accommodate households engaged in multiple industries, even if there are tens of millions of rural citizens engaged in multiple industries who are of no relevance.

Three, land transfers to family farm operations should be given priority. We should give priority to developing family farms, centered on rural households, in rural communities, particularly as the rural social insurance system remains far from perfect. We should add some conditions to the transfer of land to agricultural companies, in order to reduce the occasion of successful operations in non-agricultural operations occupying farmland to the extent possible and to prevent outside capital from occupying farmland for non-agricultural businesses.

Four, scaled land transfer behaviors. We should encourage agricultural operators to sign land transfer contracts. Particularly in cases where piecemeal land parcels are being agglomerated, operators should sign supplemental agreements the original land contractors and clarify all relevant rights.

Five, promotion of shareholding structures in collective land. China is a country where only a minority of localities can set up land shareholding structures. As long as we ensure that land contracting rights remain with rural households, we can quantify the right to contract and operate land into shares and bring about unified operations in tier-one village corporations by reconcentrating contracted land via selling shares in the new company.

The functions of the government in terms of land transfers are as follows. The government should encourage transactions in land shares within the community at the micro scale and rigorously regulate and manage institutions for land usage at the macro scale. The government should eliminate all opportunistic behavior, such as obtaining governmental agricultural subsidies via land transfers, and should stamp out the behavior of some merchants who violate policies stipulating that farmland be used for agricultural purposes. As rents for companies are generally higher than average transfer fees, and as most companies elect to hire those same people who rented the land to them, the farmers themselves benefit doubly. However, as many agricultural companies renting out land use it for purposes other than agriculture, we should be watchful for such abuses.

### ***2.3.3 Scale and Pricing of the Land Market***

Prices for transfers of agricultural land are determined by supply and demand of such land. From the perspective of selling land rights, willingness of rural citizens to transfer land rights increases in proportion to annual increases of the costs of operating their land and annual increases to incomes in non-agricultural industries. From the perspective of buying land rights, large specialized households and family farms grow more willing to buy land rights as the level of agricultural mechanization increases and as the benefits from scale operations increase. Relatively speaking, as the degree of differentiation in rural vocations increases, those adept at earning a living from working the land grow more willing to purchase land rights; so there is a degree of rigidity to the price increases of land transfers. One survey indicates that the average per  $\mu$  annual rental for agricultural land was 293 yuan in 2008, 500 yuan in 2008, 660 yuan in 2012, and 880 yuan in 2013.

Transfer prices of agricultural land correspond to not only the productivity of the land, but also to the location of the land. Prices are higher for land close to urban areas, where there is higher demand for land transfers. In economically undeveloped areas, transfer prices are low, as there is little demand for land transfers. Transfer prices for well-positioned land can run four to five times as much as for poorly-positioned land. Prices are also lower for land fragmented into many small

pieces, whereas prices are higher for large swaths of contiguous land. Land suitable for planting grain is priced lower, while land suitable for planting other cash crops is generally priced higher.

### ***2.3.4 Establishing Land Management and Farmland Protection Systems***

Over the past 30 years, the central government has used policies and laws to demarcate, standardize, and protect the land rights of rural citizens, including the right to operate contracted land, the right to use collective land intended to be built upon, and the right to use land intended for residential use. At the same time, the government has established a sound system of rules and regulations to manage land usage behavior by instituting a management system for land use and planning, a management system for land use, and a protection system for farmland.

The “Land Administration Law,” issued on January 1, 1987, was the beginning of integrated management of urban and rural land. The law laid the conditions for the establishment of a series of rural land administration institutions, including a sound land planning system, a land surveying system, a land usage planning and management system, a system for restricting the usage of land, a system for protecting farmland, and so on. The 1998 revisions to the law as well as the regulations for its implementation, clearly stipulated an overall planning system for land usage. This included the principles for the organization of that planning system, the approvals procedures, changes to authorities, the authority to make changes, and the approvals procedures for establishing overall land usage planning. Thereafter, the central government completed overall land usage planning of five tiers: nationwide, provincial (including autonomous regions and cities under direct command of the central government), provincial-level and provincial capital cities, and townships (and towns), bringing all rural land in the country within the track of centralized planning.

The 1998 revisions to the Land Administration Law brought a system of limitations on land usage within the scope of the law. The state established overall planning for land usage, dividing all land in the country into three categories: agricultural use, construction use, and unused. In order to reclassify agricultural use land as construction use land, one must go through approvals procedures. The revised law clearly stipulated that “construction use” institutions encompassed the system of compensations for occupying farmland and the system for protecting farmland within the prime farmland protection system. The system of compensations for occupying arable land demands that the unit occupying said land be responsible for developing uncultivated land of identical quality and identical area for any occupation of farmland; in cases in which the conditions for cultivating virgin land do not exist or when land thus compensated does not meet requirements, the original unit should pay “wasteland cultivation fees,” dedicated funds used to

cultivate new arable land. The prime farmland protection system demands that not less than 80% of the farmland in an administrative area be included within prime farmland protection, and that more rigorous administration and control be exerted over such land.

## **2.4 Reforms to the System and Mechanisms for Agricultural Operations**

### ***2.4.1 Reducing the Scope of Administrative Management, Establishing Norms for Administrative Management***

China has long taken development of production and protection of supply as the major objectives of agricultural policies. After agricultural development entered a new phase, agricultural policies were expanded from the sole objective of increasing output of agricultural products to also encompass increases to rural incomes, increases to comprehensive agricultural productivity, improvement of the agricultural environment, increases to the quality of agricultural products, and optimization of the agricultural industry structure. Policies were expanded from strategic adjustments based in domestic agriculture to strategic agricultural adjustments based in “the two markets” and “two kinds of resources” and from increasing the prices of agricultural products to protect rural incomes to strategies for using industries, fiscal policy and taxation, and financing to protect rural incomes. This was done to adjust to the demands of agricultural marketization, internationalization, and sustainability.

Agriculture is an industry greatly reliant upon natural endowment and the environment. In order to give rise to regional industry belts with comparative advantages, officials placed focus on the development of high technology and high added value agricultural products in eastern regions and in mid to large cities and their surrounding areas, which were to blaze the trail in modernizing agriculture. Central regions were allowed to maintain comparative advantages in grain production; officials optimized grain varieties planted and the quality structure and drove industrialized production therein. Officials made a great push in allowing grain-planting lands to revert to forests and grasslands, in the development of specialized agriculture, ecological agriculture, and water-conserving agriculture.

Changing government functions; smoothing out interdepartmental relationships; establishing an agricultural administrative management system that integrates pre-production, production, and post-production; and resolving such issues as dispersion of functions, division of industries, monopolization of sectors, and regional blockages. Concrete measures are as follows: eliminate or reduce distortions in production or prices caused by government interference; strengthen such functions as production services, food reserves, direct subsidization of producers, and regionally imbalanced development; strengthen the capacity for public services;

reduce information asymmetry; and preserve market order. Reduce government functions for administrating rural citizens and strengthen management functions over agricultural trade, food safety, and sustainable agricultural development. Reduce governmental interferences in production and trade and increase the support, protection, and comprehensive services the government provides to agriculture.

Promoting agricultural reform pilots. First, select focus industries for reform pilots. For example, establish official veterinary institutions and shore up the veterinary prevention and treatment system. Separate the administrative and executive functions from the service functions of animal husbandry and veterinary stations at every level; also separate executive personnel from service personnel. Second, select focus products for reform pilots; examples include cotton in Xinjiang, soybeans in Heilongjiang, sugar in Guangxi, fisheries in coastal regions, and so on. Third, select focus functions for administrative system reforms. For example, in production bases and wholesale markets implement compulsory quality and safety examinations and establish sound systems for tracing the origins of products. Fourth, select focus regions for reform pilots, implementing, for example, administrative system reforms that integrate agriculture, science, and education; production, processing, and sales; and trade, industry, and agriculture in designated counties and cities. Fifth, on a foundation of summarizing experience, convert more successful methods into laws and regulations and administer such on the basis of the law.

Allocate agricultural resources per the principle of comparative advantages, promote industry upgrading, protect the interests of rural citizens, maintain healthy agricultural development, and increase the international competitiveness of Chinese agricultural products. Strengthen such government functions as market construction, infrastructure construction, development of international markets, food safety, increasing rural incomes, and so on. Increase multilateral cooperation and consultations in agriculture and protect and preserve agriculture on the basis of the law.

Too many links in the administrative chain, or too great a length of such a chain, leads not only to such problems as high costs and low efficiency, but also weakens the regulatory ability of the market. To this end, the government should reduce interventions in agricultural production and markets; decrease such measures as price support through distorting production and trade behavior and marketing loans; strengthen such functions as macro-adjustment and controls, market oversight, and public services; strengthen the implementation of “green box” policies such as ordinary fiscal support of production services, food security reserves, direct subsidization of producers, and regional development plans; and do only things that the market cannot do or cannot do well. The key is to integrate functions, strengthen services, protect the rights of rural citizens, and promote agricultural development.

Clarify the scope of functions of all departments, demarcate administration authorities, establish normal procedures, and bring about symmetry in administrative authorities and administrative responsibilities. Establish a sound execution and oversight system, a support and protection system, a quality standards system, an inspection and licensing system, a market information system, and a marketing services system, in order to strengthen pre-production, production, and post-production public services and protection.

### ***2.4.2 Improving Laws and Regulations, Governing in Strict Accordance with the Law***

Revise and improve relevant laws and regulations. Establish laws for agricultural macro-adjustments and controls, agricultural support and protection, market entry, protection of agricultural resources and environments, and so on. Strive to bring about good public services. Earnestly perform such functions as carrying out plans, making adjustments, regulating, and providing services.

Shore up the legal system. Strengthen the dominant position of the market, standardize the economic order on markets, and bring about economic development of markets. Allow markets to play a decisive role in resource allocation and reduce direct intervention into microeconomic activities.

The transparency, stability, and fairness of policies and administrative measures ensure stable expectations for market entities.

Agricultural administration in China has long relied on administrative edicts, and agricultural legislation and execution thereof have begun relatively late. Existing agricultural laws and regulations are skewed toward agricultural production and protection of agricultural resources. We must now take aim at laws in the fields of protecting the dominant position of agriculture, trade of agricultural products, and agricultural investments, and upgrade existing documents and regulations into formal laws and regulations. Consummate the system of agricultural laws and regulations, and bring about administration and protection in accordance with the law.

Expand market entries, reduce domestic support, and abandon export subsidies and special protections per World Trade Organization (WTO) entry protocols. Improve quarantine procedures for animals and plants, health standards, protections of intellectual property rights, and so on. Be proactive in adjusting to and making use of multilateral trade regulations, drive reforms to the agricultural administrative management system, and bring about healthy development in agriculture.

Implement government openness institutions and accountability institutions. Apply administrative and executive accountability into every link and every individual, ensure symmetry of authorities and responsibilities, and see that there are checks on power. Drive increases to the level at which governance is in accordance with the law.

Governance in accordance with the law. Set norms for governmental behaviors per the strategy of ruling the nation in accordance with the law. Strengthen agricultural legislation, increase executive powers, shore up executive teams, and increase the level of legislative execution. Establish sound oversight mechanisms, prevent and reduce “government malfunctions,” and promote democratization and scientification of policymaking.

Establish a sound system of law execution and administration of agriculture that conforms to the demands of the market economy, a market information system for agricultural products, a quality standards system for agricultural products, an inspection and certification system for agricultural products, a safety and oversight system for agricultural production, a system for technical and marketing services for

agriculture, a system to oversee the agricultural resources environment, a system to support and protect agriculture, and a system for agricultural product reserves management.

Deepen reforms to the agricultural administrative management system in China, eliminate systemic obstructions impeding development of production, and promote healthy development of agriculture in China. Establish an integrated, efficient administrative system of balanced authorities and responsibilities and that unifies agriculture, science, and education; production, processing, and sales; and trade, processing, and agriculture. Transform government functions and strengthen public services.

Improve the systems for inspections and certifications and for quality standards. The first is self-inspection quality institutions for companies. Improve inspection methods and increase the capacity for inspections. Improve the certifications system at the levels of production environment, inputs, production and processing processes, packaging marks, and so on, as well as the management of certification of agricultural products. Ensure the quality and safety of agricultural products. Promote certifications such as GMP (good manufacturing practices), HACCP (hazard analysis critical control point), ISO9000 (standards for quality assurance and quality management), and ISO14000 (standards for environmental management and protection). Guide producers to develop product certifications. Elevate agricultural standards to coercive technical regulations. Encourage agricultural companies to establish internal control standards to serve as the technical bases for organizing and standardizing production, processing, and sales behaviors.

Clarify executive bodies, standardize the structure of such bodies, improve executive systems, bring about cooperative execution of laws, increase the strength of executive bodies, increase the level of execution, strengthen the fairness and authority of executive bodies, and safeguard the effective implementation of agricultural laws and regulations.

### ***2.4.3 Expanding the Scope of Economic Administration, Improving Economic Management Methods***

Establish an administrative system of “complete systemic preparations, reasonable division of labor, symmetric authorities and responsibilities, coordinated operations, and standardized behaviors” that is suited to market economy rules, in line with the thinking of pre-production, production, and post-production integrated management, and in accordance to the demands of stabilizing agricultural product markets, ensuring agricultural product security, increasing rural incomes, and increasing the competitiveness of agriculture, in order to adjust to new opportunities and challenges brought on by globalization.

The main point of reforms is to augment the role that markets play in resource allocation, to reasonably demarcate the scope of functions and authorities between

sectors and within sectors, to bolster government functions and the service functions of social organizations, and to improve the government's administrative system.

Agricultural product markets have five basic functions: collection and distribution of commodities, price formation, and information dissemination. Allowing agricultural product markets to fulfill these functions plays an important role in guiding rural citizens to adjust the agricultural structure, vitalizing agricultural product circulation, increasing rural incomes, and accelerating urbanized construction. Establish a unified, open, competitive, orderly agricultural products market system with such modern market circulation measures as distribution chains, electronic trading, and futures trading as the forerunners, wholesale markets as the heart, and retail sales stores, trade and market centers, and supermarkets as the foundations. Build and develop an agricultural product market system at the following seven levels: one, improve service functions; two, drive innovation in circulation systems of agricultural product markets; three, reform the trade methods and operations and management models of wholesale markets for agricultural products; four, accelerate the implementation of market entry institutions for agricultural products; five, improve systems for the collection and dissemination of market information; six, increase the degree of organization of market entities; and seven, strengthen market management.

Implement comprehensive management adapted to the demands of the market economy and establish public organs on the basis of functionality. Two, clarify the positioning of functions and strengthen public services. Integrate the management functions of the quality and safety system and the quality inspection and examination system for agricultural products. Integrate the functions of the construction of market systems and information systems for agricultural products with agricultural products and agricultural input market services as the core. Integrate such services as research and development, marketing, and services for agriculture with increases to agricultural competitiveness as the core. Three, synthesize reforms to public institutions and strengthen such administrative and execution functions as veterinary services, plant protection and quarantine, pesticides and animal medicines, chemical fertilizers, seeds, and so on. Four, continue to transform government functions; convert administrative approvals into such public services as the provision of market information, technological consulting, disaster forecasting, product inspections, marketing services, infrastructure construction, and so on. Improve international cooperation and communication and fulfill the dual duties of protecting China's agriculture and developing international markets.

One, sort out the relationship between sectors and resolve the problems of overlapping and superimposed functions. Two, properly divide responsibilities and increase the reciprocity of the various administrative bodies. Three, protect agricultural resources and the ecological environment and shore up the foundations for eternally sustainable agriculture. Four, establish institutionalized consultation mechanisms for sectors and ensure coordination between agricultural sectors.

## 2.5 The Experience of China's Rural Reforms

China's economic reforms began in the agricultural sector. The objectives of 30 years of agricultural reforms have been gradual and progressive. Rural reforms in China may be broken into three phases, per changes to the objectives of such reforms. The first phase of reforms was intended to incentivize rural citizens to produce more agricultural products and resolve the issues of widespread rural poverty and insufficient food supply. The most fundamental measure implemented was the Household Responsibility System, which transformed collective agricultural operations into household operations. The second phase of reforms was intended to establish the market economy and bring about economic system restructuring. The specific measures taken in this phase were aimed at developing product markets and factor markets. The third phase of reforms was intended to establish a system and mechanisms that integrated rural and urban planning and to bring about fairness in the rights of rural citizens. The concrete measures taken in this phase were aimed at establishing equality in urban and rural basic public services. During this process, first the government made the transition from doing everything toward only playing an administrative role, and then the government transitioned from administration toward the provision of services.

The Household Responsibility System, created by China's rural citizens in the course of their practical lives, shattered the barriers of the planned economy and brought rural citizens onto the road of growing rich through labor. The process of this mighty reform could be divided into two very clear threads from beginning to end: systemic innovation and the development of markets. The process whereby agriculture and the rural economy in China became marketized was a process where traditional agriculture transitioned into modernized agriculture, and so the experience we gained from these rural reforms was most valuable indeed. This experience is not only of significance for informing our next step in agricultural economic reforms, but it provides lessons for reforms in other economic fields in China and urban centers to draw from.

### 2.5.1 *Enormous Potential for Rural Economic Growth*

China's history of revolution and development demonstrates that the power behind both reforms and development lies primarily in the countryside and in the persons of rural citizens. During the era of the New Democratic Revolution, the success of said revolution was won by releasing enormous potential for revolution of the countryside and the peasantry by satisfying the land requirements of the peasantry. In the era of Reform and Opening, China has been led onto the track of rapid development by releasing the potential of incentivizing the countryside and rural citizens by satisfying the needs of rural citizens to have autonomy over their production. In the new stage of development, we must release the enormous potential

energy of the countryside and rural citizens by satisfying their demands for a moderately prosperous life, and thus truly alight upon the development path of Chinese characteristics.

Rural citizens comprise the majority of China's population, and rural land accounts for the vast majority of all land in China. This basic national condition demonstrates that if we don't handle rural issues well, then we won't be able to handle China's issues well; if rural citizens are poor, then China cannot become rich and powerful; and if agriculture is backward, then China will not be able to bring about modernization. Thus, during this new stage of development, we should place importance on the countryside, care about the countryside, give full rein to the incentives and innovativeness of rural citizens, and ensure sustainable development of both the countryside and agriculture. This will be the key to China's modernization.

### ***2.5.2 Market Guidance: An Important Factor in Rural Growth***

The past 30 years of experience demonstrate that market guidance reforms are one of the most key factors to the rapid growth of China's agriculture. Over the short term, driving up productivity at the individual level has indeed driven growth in agriculture, but this method will maintain the relative advantageousness of rural agriculture, and will lead to the negative result of extending the process of recreating traditional agriculture. A more appropriate choice would be to spur factor fluidity by relying upon market mechanisms and thereby greatly decrease the marginal productivity differences in resource allocation.

Over these past 30 years, as product markets and factor markets have grown, the effect of market mechanisms on agricultural resource allocation has grown more pronounced, and rural microeconomic foundations have grown more adapted to market mechanisms. At the same time, as compared with the objectives of the establishment of the nationwide integrated market system, the countryside requires another series of market-oriented economic reforms.

### ***2.5.3 Non-agricultural Enterprises to Become Mainstay of Rural Development***

Over the past 20 years, the rapid rise of TVEs made those enterprises the major sector driving economic growth in China. They not only propelled the industrialization and urbanization of the countryside, but also provided experience for explorations toward a modernization road suited to China's national conditions. From the outset, TVEs faced market competition, and so market mechanisms are

naturally adaptable. The economies of scale of non-agricultural industries are quite pronounced. TVEs do not primarily pursue internal economies of scale, but rather external economies of scale formed by the regional agglomeration of many enterprises of the same nature. Their original method of decentralized production but centralized sales drove the development of both wholesale commodity markets and of cities. The method of enterprise spatial aggregation appeared afterward, which has since driven the development of small and mid-sized cities.

The effect of market mechanisms is as follows: they use economic signals to induce rural production toward sectors and regions of high productivity and high rates of return. These in turn drive increases to rural incomes and eliminate disparities in rates of return between industries and disparities in development between urban and rural areas. The effect of government macro-adjustments and controls is as follows: they increase the supply of rural public products and social welfare and rapidly eliminate disparities in the supply of public products and social welfare between urban and rural areas and between regions.

The experience of rural reforms is as follows: the abandonment of high-degree controls on rural citizens enabled rural citizens to autonomously allocate their own resources on the basis of market information, which was advantageous to increasing agricultural production and rural incomes as well as driving rural development. Local governments were encouraged or allowed to actively explore and adopt new regulations and to promote systemic innovation. After new rules and institutions were universally put in place, they were upheld by state policies and laws. China's rural reforms were all pushed by grassroots governments, whether in matters of the Household Responsibility System, TVEs, or village autonomous governance; they were driven forward amid conflicts with preexisting policies. Increases to rural incomes came mostly from increases to agricultural productivity, upgrades to the agricultural industry structure, and shifts in rural labor. The primary contribution of the government was to increase supply of rural public products, thereby laying the foundations for rural citizens to increase incomes and make innovations.

Empowerment is an effective method in further allowing the potential for wealth creation of rural citizens to play an even bigger role, and is also the basic experience of state and rural development in China since Reform and Opening. Rapid growth in agricultural products shortly after Reform and Opening was the result of granting rural citizens autonomy to operate their own land. The rapid rise of non-agricultural industries in rural and urban areas in the mid-1980s was the result of empowering rural citizens to choose their own employment opportunities. Improvements to the relationships between leaders and the masses in grassroots rural communities was the result of empowering rural citizens to choose their own village leaders. Empowering rural citizens is advantageous to increasing the reciprocity of government objectives and the objectives of rural households, which thereby garners widespread support for government objectives among rural citizens. Nevertheless, the process of empowering rural citizens remains incomplete, and as such remains a cardinal focus for deepening rural reforms.



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