Economics and political economy of agricultural trade-related policies in China

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Abstract

This thesis seeks to understand the simultaneous economic and political contributors to China's changing agricultural protection levels and the central government's choice of policy instruments to tax or assist farmers. It begins in Chapter 2 by theoretically exploring the motivations behind agricultural trade-related support policies through extending the two-sector specific factors production model to three sectors, to make it more relevant for a one-party state such as China. That review suggests the switch from taxing to subsidizing the agricultural sector depends not only on changes in the economy's structure but, more critically, on the underlying political support from heterogeneous interest groups in the course of economic development. The equilibrium agricultural protection level is determined by equating the marginal political returns from supporting farmers to marginal political costs from opposing groups (including manufacturers).

Chapter 3 tests that theory empirically, using panel data on agricultural distortions for the period 1981 to 2010 from Anderson and Nelgen (2013). When using the relative rate of assistance as the agricultural protection indicator, the results are robust. The study concludes that (1) arable land per capita, the proportion of the workforce in the agricultural sector, and the self-sufficiency ratio are more significant in China that elsewhere; and (2) inequality is more significant than poverty in contributing to the changes in China's agricultural trade-related policies.

Around that long-running trend in the level of assistance to the farm sector are considerable fluctuations in support from year to year, not least because of fluctuations in international prices of agricultural products. Chapter 4 seeks to explain the Chinese government's responses to world market price fluctuations. It develops a theoretical model of trade policy incorporating loss aversion and reference dependence. Like Freund and Özden (2008), this chapter (unlike Chapter 5) assumes only trade policy instruments are available to the

government, but it goes beyond their model by adding a spatial dimension to interest-group politics. The model suggests that: (1) politically sensitive products receive more trade protection; (2) the government's changing trade distortions insulate the domestic market from international price fluctuations by setting trade protection lower (higher) when the world price is higher (lower) than a targeted domestic reference price; and (3) variations in market intervention help producers at the expense of consumers in periods when the international price is well below trend, and help consumers at the expense of producers in high-price periods. These predictions from theory are shown to still hold when the model is extended to a large country case involving terms of trade effects. The model is tested empirically and found to offer a plausible explanation of the puzzling changes in cotton protection in China.

In practice, the government does have other instruments besides trade restrictions to alter domestic producer and consumer prices in the face of fluctuating international prices. Chapter 5 explores the role that public storage policy can play in contributing to the government's objective of stabilizing the domestic market price of farm products. The political economy theory developed in Chapter 4 is extended to incorporate domestic storage, so as to explore government motivations in the context of border and domestic policy coordination. Domestic storage policy can add to price stabilization in the presence of trade policies, and can reinforce a price-insulating trade policy through increasing the country's market power. However, the effects of these two price stabilization instruments on the international market price are in opposite directions. The effect of storage on the world market is then tested, again using China cotton as a case study. The VAR econometrics reveal that in the case of cotton during 2011-14, China as a large player in the global market was able to stabilize to a non-trivial extent the international price of cotton through altering its public stockpile.

The final Chapter of the thesis draws out implications for policy makers in China and elsewhere. One is that the Chinese government should not apply trade distortions since they reduce resource allocation efficiency, social welfare, and consumer utility. Another is that domestic public storage policy, rather than trade distortions, could be an effective way to achieve domestic political targets. If managed well enough, storage could be less distortive of world agricultural markets than trade policy; but if poorly managed, it could add to the disruptions that trade policies bring to those markets.

Key words: Political economy, agricultural trade-related policies, public storage policy, international market price volatility, geographic politics, loss aversion, specific factor model, political support model, cotton, China

JEL classification: C32, E64, F13, F14, F59, Q11, Q17, Q18, D72, O38

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