

An End to China's Agriculture Tax

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China's No. 1 Document of 2004 put the issue of farmers' incomes at the forefront of the policy agenda. The No. 1 Document of 2005 reaffirmed this priority.¹ The documents, jointly issued by the Communist Party Central Committee and the State Council, commit to deepening rural tax reform and reducing the financial burden on farmers. Not since the 1980s have rural problems been given such high priority. No. 1 Documents on rural work were put forth annually from 1982 to 1986. Even then, however, the emphasis was always on production. The No. 1 Document of 2004 was the first such document to focus on farmers' incomes.²

The centrepiece of the programme is the elimination of the agriculture tax over a five-year period. It follows efforts begun in the late 1990s to consolidate a plethora of rural taxes and fees into a single unified tax. Even with this consolidation, the revenue share of the agriculture tax in China's total fiscal budget remained small, just 1.7 per cent in 2003.³ At the township and village level, however, where it is easily administered and serves local spending needs, this tax plays a crucial role, especially in poor areas lacking other tax bases. Thus, elimination of the agriculture tax had to be tied to the institution of a centrally coordinated revenue sharing scheme and to shifts in responsibility for public service provision to higher levels of government. Otherwise, there would be no hope of restraining taxation and fees at the local level.

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The decision to do away with the agriculture tax fits squarely into the “pro-people” policy orientation of the Hu-Wen government and is motivated by a variety of concerns.⁴ On equity grounds, those who occupy the bottom rung of China’s economic ladder and who in relative terms have been slipping behind — farmers — will be the beneficiaries. On economic grounds, maintaining incentives to farm is of growing importance as farmers gain broader access to competing employment opportunities and farming becomes a more active choice. Moreover, on political grounds, widespread discontent in the rural areas is erupting into protests and threatening to undermine social stability.

Repeal of the tax is scheduled to be phased in nationwide over a five-year period through 2008. The more heavily agricultural provinces are to proceed most aggressively. Heilongjiang and Jilin forged the way, eliminating the tax completely in 2004. Another 11 provinces reduced the tax rate three percentage points from the existing ceiling of 8.4 per cent. These 13 spear-heading provinces are receiving full reimbursement by the central government for the loss in revenue. The remaining provinces must rely on internal funds to compensate sub-provincial levels of government as warranted, having been directed to reduce the tax rate by at least one percentage point in 2004.

In 2005, all poor counties — amounting to a quarter of the total nationwide — are to see the tax completely eliminated. The central government has committed RMB50 billion for the year to reimbursements. As of early in the year, progress was faster than planned with 22 provinces already having eliminated the tax entirely.⁵

¹ The 2004 No. 1 Document at <<http://www.china.org.cn/chinese/2004/Feb/492960.htm>> [27 May 2005], has commentary by Xinhua Agency. The 2005 No. 1 Document at <<http://politics.people.com.cn/GB/3154882.html>> [27 May 2005], has commentary by Central Leading Group on Finance Vice-Director Chen Xiwen.

² Every year hundreds of numbered documents are issued by the central government. Since the No. 1 documents on rural work in the 1980s, however, the first document of the year has received no particular fanfare. Only with the desire to accord special significance to agriculture has the symbolic value of the No. 1 Document been rejuvenated.

³ The fiscal budget here refers only to the formal budget and excludes “off-budget” (*yusuan wai*), “off-off-budget” (*yusuan wai zhi wai*), and “off system” (*zhi du wai*) activity, which is much harder to document.

⁴ See Zheng Yongnian and Lye Liang Fook, “China’s Politics in 2004: Dawn of the Hu Jintao Era”, *EAI Background Brief No. 221*, 28 Dec. 2004.

⁵ “Tax Exemption Heralds New Life for Farmers”, *China Daily*, 25 Jan. 2005.

Indications are that the policy is having the desired effect. According to the *People's Daily*, "In 2004, increase in grain production has become the brightest colour in China's economic chart."⁶ The rise in grain output was 9.0 per cent, reversing a declining trend since 1999. Rural income per capita increased by 6.8 per cent, still lagging behind the urban growth rate of 7.7 per cent but at least narrowing the growth differential.⁷ Reduction in the agriculture tax is among the factors being credited for these achievements along with buoyancy in grain prices largely resulting from the state's restraints on market supplies.

Historic Shift in State-Peasant Relations

Elimination of the agriculture tax marks a fundamental reorientation of relations between the state and peasants. Throughout Chinese history, the main concern of the state with regard to the peasantry has been to extract revenue. In return, the state has provided protection and certain public services such as irrigation and technology extension aimed at raising output.

Since 1949, the state has relied heavily on indirect as well as direct taxation of agriculture, first to mobilise investment for an ambitious programme of industrialisation (1949–85), and later under reform to ensure urban stability through affordable food supplies (1985–92). Since the mid-1990s, the rural tax burden has remained heavy simply due to the need to support local government functions.

Extraction of rural surplus was carried out during the Mao years by means of the "price scissors" which turned the intersectoral terms of trade against agriculture. Urban residency was strictly controlled through the *hukou* system. Price distortions were gradually unwound under post-Mao reforms through the transition device of dual-track pricing which freed prices on above-quota market sales. Market elements were further grafted onto the core socialist system by allowing rural townships and villages to develop industrial enterprises, and labour to migrate under a permit system to urban

⁶ "2004 — Chinese Farmers Are Harvesting with Joy", *People's Daily Online*, 13 Dec. 2004, <http://english.peopledaily.com.cn/200412/13/eng20041213_167139.html> [27 May 2005].

⁷ "Stable and Rapid Development of the National Economy in 2004", *National Bureau of Statistics*, 25 Jul. 2005, <http://www.stats.gov.cn/english/newrelease/statisticalreports/t20050125_402225589.htm> [27 May 2005].

jobs. The old system remained intact, however, with regard to taxation, land rights and residence registration.

An overhaul of the national tax system in 1994 only increased the burden on farmers. This reform saw a sharpening of the delineation in revenue sources and expenditure obligations between central and local levels in combination with the introduction of a value added tax. The result was a growing strain on governments at lower levels which had to fill a widening gap between revenues and expenditure needs. Township and village level governments were left to rely on the agriculture tax and an array of other discretionary and widely varying taxes and fees.

The impact of the 1994 tax reform shows up clearly in Table 1. Local government tax revenue at the provincial level and below plummeted even as revenue from the agriculture tax almost doubled. The share contribution of the agriculture tax in local revenue jumped from 2.1 per cent to 5.2 per cent. Simultaneously, revenue from an array of crop-specific special products taxes, which are also to be eliminated along with the general agriculture tax, with the exception of the tax on tobacco, more than tripled.

Local governments also relied increasingly on a system of fees known as "*san ti wu tong*". The *san ti*, or three remits, were paid by farmers to the village and refer to fees for social welfare, infrastructure and management. The *wu tong*, or five unifies, were paid to the township for education, family planning, paramilitary support, infrastructure and irrigation, plus an appended sixth category of public health. Recourse to the *san ti wu tong* fees grew over time in ways that were often unseemly, and that met with mounting objection from farmers. In the latter 1990s, the central government began to push for conversion of "fee to tax" (*fei gai shui*) to regularise revenue collection in the countryside, and localised experiments were carried out.

A symbolic landmark in state-peasant relations was achieved in 1998 with the articulation of the "three-dimensional rural problem" (*san nong wenti*) which recognises the intertwined issues of agriculture, village and farmers (*nongye*, *nongcun* and *nongmin*). The crux of this three-dimensional rural problem is the need to sustain increases in farmers' incomes through agricultural productivity gains and improvements in village governance. A revamping of rural taxation and spending is integral to the agenda.

By the late 1990s, agricultural product prices were falling, and total output value actually declined in 1999 and again in 2000 (see Table 1). The need for relief to farmers became pressing. The fee-to-tax reform was expanded

Table 1. Tax Revenue by Year

	Government Revenue* (RMB billion)				Agri. Output Value (RMB billion)	Agriculture Tax Share (%)		
	Total	Local**	Agri. Tax [§]	Special Products Tax		in Total Revenue	in Local Revenue	in Output Value
1990	294	194	6.0	1.2	495	2.1	3.1	1.2
1991	315	221	5.7	1.4	515	2.0	2.6	1.1
1992	348	250	7.0	1.6	559	1.8	2.8	1.3
1993	435	339	7.3	1.8	661	2.0	2.1	1.1
1994	522	231	12.0	6.4	917	1.7	5.2	1.3
1995	624	299	12.8	9.7	1,188	2.3	4.3	1.1
1996	741	375	18.2	13.1	1,354	2.1	4.9	1.3
1997	865	442	18.2	15.0	1,385	2.5	4.1	1.3
1998	988	498	17.9	12.8	1,424	2.1	3.6	1.3
1999	1,144	559	16.3	13.1	1,411	1.8	2.9	1.2
2000	1,340	641	16.8	13.1	1,387	1.4	2.6	1.2
2001	1,639	780	16.4	12.2	1,446	1.3	2.1	1.1
2002	1,890	852	32.1	10.0	1,493	1.0	3.8	2.2
2003	2,172	985	33.8	9.0	1,487	1.7	3.4	2.3

Notes: * Revenue does not include receipts from domestic and foreign borrowing.

** Local refers to provincial level and below.

§ Includes animal husbandry tax (RMB0.15 billion in 2003) which is also to be eliminated.

Sources: China, National Bureau of Statistics, China Statistical Yearbook 2004 (Beijing: China Statistics Press, 2004), pp. 292, 306, 476; China Finance Ministry, Finance Yearbook of China 2003 (Beijing: China Finance Periodicals Press, 2003), p. 344.

geographically and finally went nationwide in 2002 by which point all rural fees were supposed to be rolled into the agriculture tax. The impact is reflected in a near doubling in agriculture tax revenue in that year that put the share of revenue from this tax in all local revenue at 3.8 per cent. Its share in agricultural output value doubled to 2.2 per cent.

Having mandated the consolidation of rural taxes and fees into the formal vehicle of the agriculture tax, the centre turned around and took the dramatic step in 2004 of announcing the tax's elimination. The void is to be filled by a combination of centrally orchestrated revenue sharing and the shifting of responsibility for local public services upward to the counties.

Rural Policy Reform Package

In addition to the elimination of the agriculture tax, current rural policy reforms encompass complementary measures aimed at improving the lives of rural dwellers. The policy package is formulated to cope with the legacy of the Maoist development strategy which involved high national investment rates but grave over-retention of labour in agriculture. The Maoist strategy was served by keeping labour in the countryside because this permitted consumption to be suppressed and investment thereby to be inflated. Over time, however, the cumulative allocative and productive inefficiencies that resulted under this strategy overwhelmed the contribution to growth that could be achieved by puffed up investment rates.

With reform, labour has had to be reallocated out of agriculture on a grand scale. But the goal of realigning factor proportions has had to be carefully balanced against the goal of preserving living standards in the cities. To that end, restrictions on rural labour mobility have only gradually been relaxed and returns to farming only gradually raised. At this point in the process, non-farm job creation has gained sufficient momentum that mobility can be freed — but in counterbalance, farming must also be made more attractive. In addition to repeal of the agriculture tax, the policies contained in the current package include elimination of restrictions on labour migration, protection of agricultural land rights and a commitment to supporting rural incomes through price supports and subsidies.

As of 2004, rural citizens are legally free to migrate to urban areas without restriction and to take jobs without limitation. Fees to obtain temporary urban residence permits which used to cost hundreds of yuan are now a nominal RMB10. Legally, migrants are entitled to send their children to urban schools and obtain health care at urban facilities. In practice, barriers to urban assimilation remain, but these barriers are no longer of a legal nature.

To improve the circumstances of those who stay behind in rural areas, the securing of land rights is key. Farmers in vast numbers have found themselves displaced from their land with virtually nothing to show for it, the victims of urban expansion which greatly enriches those on the taking side. Efforts are being made in the legal realm to address this problem. In 2002, the “Rural Land Contract Law” was promulgated, and 2003 saw, significantly, an amendment to the constitution requiring that compensation be given to rural land occupants whose land is expropriated. The important question of how to set the amount of compensation remains to be addressed in the land law now in the drafting stage. Temporary respite to farmers from land takings was afforded in 2004 by prohibitions against land transfer out of agriculture under a broad programme to rein in an overheating economy. The halt on land transfer was called in April for an initial period of six months, but the government has since announced that controls will remain tight even after the halt expires. The stated policy goal is to allow no net reduction in cultivated land area from the current level.

Supporting grain farmers in particular is of great concern to the Chinese Government, and to this end, price support and subsidy policies have been implemented. A support price for rice was established by Zhu Rongji in the late 1990s and is guaranteed under the central government budget. Although market prices have since risen to above the support level, and the support price is thus not currently binding, it remains nominally in effect as insurance against any future drop in market prices. In 2004, absent the need to expend funds for maintaining the support price, a subsidy was paid directly to grain farmers in the 13 major grain producing provinces. The sum paid out under this programme amounted to RMB10 billion with payment due farmers on a per cultivated *mu* basis.

Within the context of rural development policy, repeal of the agriculture tax plays an important role. Based on the situation in 2003, the measure will provide RMB34 billion a year in relief to farmers, or about 2.3 per cent of agricultural output value. Also to be eliminated are the animal husbandry tax, worth RMB0.15 billion in 2003, and a wide array of special product taxes, worth RMB9 billion, but of which the tax on tobacco is to be retained.⁸ Revenue

⁸ Although the data sources do not report revenues separately by product, the tax on tobacco would appear to be a significant revenue generator because Yunnan Province specialises in tobacco and is the source of more than 20 per cent of revenue nationally from special products taxes (see Table 2).

from special product taxes, in contrast to that from the general agriculture tax, has been on the decline for some years having peaked at RMB15 billion in 1997 (see Table 1).

Although the 2.3 per cent average tax rate relative to output value may not initially seem overbearing, due to unevenness in tax application and underreporting of revenue collection to higher authorities, this figure does not capture the severity of the burden that falls on many farmers. The authorised ceiling on the tax rate is 8.4 per cent of output value. Further, the tax is applied on a cultivated acreage basis with respect to imputed output, including that self-consumed. Thus as a percentage of net income on output actually marketed, the rate is much higher than the 2.3 per cent figure suggests.

Moreover, the tax burden on farming increased significantly with the fee-to-tax conversion that went nationwide in 2002. Prior to this, fees were assessed on a broad range of non-agricultural activities in rural areas. So the effort to regularise local revenue collection also had the effect of shifting the tax burden to households concentrating on farming, an effect that was both inequitable and a disincentive to farm.

Coping with Tax Revenue Losses

Loss of revenue from the agriculture tax will cut deeply into village and township budgets. This problem is to be managed through a combination of compensation from higher levels and a shifting of responsibility for public services upward to the counties. There is also room for streamlining administration and cutting expenses to ameliorate the strain, particularly through consolidation of administrative jurisdictions and reduction of excessive government employment.⁹

The provinces most dependent on the agriculture tax will be compensated for lost revenue by the centre, as indicated in Table 2. Topping the list, Anhui depends on the agriculture tax for 12 per cent of all local revenues. All provinces relying on the agriculture tax for more than 5 per cent of local revenues will receive centre compensation, with the exception of Gansu which is also a relatively low income province (GDP per capita of only

⁹ Lin Shuanglin notes that between 1978 and 1997, the number of staff in government and Party agencies and social organisations ballooned from 4.17 million to 10.74 million. See "Too Many Fees and Too Many Charges: China Streamlines Its Fiscal System", *EAI Background Brief No. 66*, 28 Jul. 2000.

Table 2. Agriculture Tax Revenue by Province

Centre Pays	Tax Revenue (RMB million)			Agri. Output Value (RMB million)	GDP per Capita (RMB)	Agriculture Tax Share (%)	
	Total	Agri. Tax*	Special Product Tax			in Total Tax	in Agri. Output
Anhui ✓	22,075	2,668	2	61,790	6,455	12.1	4.3
Henan ✓	33,805	3,771	271	113,770	7,570	11.2	3.3
Jiangxi ✓	16,817	1,570	32	38,370	6,678	9.3	4.1
Hubei ✓	25,976	2,320	268	73,340	9,011	8.9	3.2
Hebei ✓	33,583	2,500	83	95,830	10,513	7.4	2.6
Hunan ✓	26,865	1,817	805	67,170	7,554	6.8	2.7
Jilin ✓	15,400	1,017	206	43,830	9,338	6.6	2.3
Heilongjiang ✓	24,886	1,628	167	50,290	11,616	6.5	3.2
Gansu	8,766	559	111	27,580	5,002	6.4	2.0
Sichuan ✓	33,659	2,113	185	80,470	6,418	6.3	2.6
Shandong ✓	71,379	4,240	1,202	159,930	13,661	5.9	2.7
Inner Mongolia ✓	13,872	717	105	33,600	8,975	5.2	2.1
Qinghai	2,404	113	27	2,970	7,277	4.7	3.8
Guizhou	12,456	516	497	27,550	3,603	4.1	1.9
Chongqing	16,156	623	138	27,040	7,209	3.9	2.3
Shaanxi	17,733	665	421	33,440	6,480	3.7	2.0
Jiangsu ✓	79,811	2,660		98,120	16,809	3.3	2.7

Table 2. (continued)

Centre Pays	Tax Revenue (RMB million)			Agri. Output Value (RMB million)	GDP per Capita (RMB)	Agriculture Tax Share (%)	
	Total	Agri. Tax*	Special Product Tax			in Total Tax	in Agri. Output
Guangxi	20,366	678	1,119	50,080	5,969	3.3	1.4
Xinjiang	12,822	347	126	48,280	9,700	2.7	0.7
Ningxia	3,003	74		5,410	6,691	2.5	1.4
Shanxi	18,605	394	9	24,950	7,435	2.1	1.6
Yunnan	22,900	479	2,007	43,390	5,662	2.1	1.1
Liaoning ✓	44,705	723	309	49,730	14,258	1.6	1.5
Hainan	5,132	48	350	15,270	8,316	0.9	0.3
Zhejiang	70,656	544	0	52,940	20,147	0.8	1.0
Guangdong	131,552	798	138	85,170	17,213	0.6	0.9
Fujian	30,471	118	371	46,680	14,979	0.4	0.3
Tianjin	20,453	36	1	8,820	26,532	0.2	0.4
Beijing	59,255	56	9	8,880	32,061	0.1	0.6
Shanghai	88,623	12		9,820	46,718	0.0	0.1
Tibet	815			2,530	6,871	0.0	0.0
Total	984,998	33,804	8,960	1,487,040	9,101	3.4	2.3

Notes: * Includes animal husbandry tax (RMB0.15 billion in 2003) which is also to be eliminated.

Sources: China, National Bureau of Statistics, China Statistical Yearbook 2004 (Beijing: China Statistics Press, 2004), pp. 63, 298-301, 476.

RMB5,000 versus the national average of RMB9,100). In contrast, the centre is compensating Jiangsu and Liaoning even though their GDPs per capita, at RMB16,800 and RMB14,300 respectively, rank well above the national norm. Indeed, a number of provinces being compensated have relatively high per capita GDP levels.

Those provinces not being compensated by the centre will have to depend on local resources to compensate hard hit rural areas. By first rolling local fees into the agriculture tax, and then eliminating that tax, the centre will have left many localities stretching to make ends meet. This move aggravates a problem that has been building since the 1994 tax reform which assigned 75 per cent of value added tax revenue to the centre and only 25 per cent to the localities. Under this tax structure, between 1997 and 2003, central government revenues increased by about 180 per cent, local revenues by only 120 per cent. Expenditure needs, however, have been on the opposite trajectory with localities facing more rapid growth in their burdens than the centre. This has left many village and township governments deep in debt with payments owing local banks and households.

One important source of relief to township and village governments is the shifting of responsibility for education and health care services upward to county level. Funding for the county level programmes is in turn to rely on increased revenue sharing from central and provincial levels.

The relatively flush situation at the centre creates the capacity for inter-regional redistribution. In 2004, central government revenues came in at roughly RMB400 billion over budget. Growing regional disparity has been recognised by the Chinese Government as a matter of priority concern. Eliminating the tax on agriculture and mobilising fiscal transfers to compensate local governments can address the problem to some extent, at least in principle. In practice, however, there are problems moving funds through the budgetary layers of the bureaucracy and ensuring the endpoint is as intended. The process lacks transparency and effective checks.

Tax relief and subsidies to farmers are a stopgap approach to solving the equity and incentive problems in the agricultural sector. Ultimately, the real key to sustaining increases in farm incomes lies in transferring labour to non-farm jobs. As the productivity of those remaining in agriculture rises, staking out a rural tax base will not be so difficult.