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EXAMINING ASIA

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A New Breakthrough For Chinese Farmers?

Even as China's economy booms, a crisis is brewing in the countryside. Some 800 million rural residents are being left behind. Their incomes are stagnating, or even shrinking when the takings of predatory local governments are taken into account. There is not enough work on the farms and in township enterprises, meaning as many as 200 million of rural people are unemployed. Their anger at corrupt and arbitrary officialdom is exacerbated by the feeling that there is little hope for the future.

This is in contrast with the early years of the reform era, when farmers' incomes were growing faster than the wages of industrial workers. The Household Responsibility System broke up the communes and gave farmers individual plots of land to work. They got to keep whatever they produced in excess of a set quota of grain. As a result, they invested their own sweat -- and eliminated food scarcity within a decade. It was a great object lesson in how granting property rights, even partial ones, can produce an increase in wealth, with very little downside.

The farmers' successes allowed Deng Xiaoping to extend his reforms to the cities. Unfortunately, from then on China applied the power of property rights mainly in the cities. Urban dwellers were given the right to buy and sell land, and within limits to use it as they wanted. That gave them a higher degree of certainty about the future which allowed them to invest in their enterprises.

But in the countryside, reform stalled. The memories of landlords and tenant farmers before the revolution were still strong; stamping out this "exploitation" was one of the chief accomplishments of the Communist Party, and as long as it remained in power it was difficult for officials to condone the concentration of land in the hands of a few. Therefore, when a village's population changed significantly, the local administration would typically reallocate the land, taking it away from families with fewer members and giving it to those with more, so that the distribution was equal again.

This had a perverse effect on farmers' behavior. Although they had been granted long leases on their land, these could be cancelled at any time. Thus there was an incentive to get as much production out of the land with the minimum investment. Protecting the land's fertility or spending on irrigation made no sense, let alone planting fruit trees, given that the land would belong to someone else within a few years.



Beijing's obsession with food security made things even worse. In order to make China self sufficient in grain, officials forced farmers to keep on growing grain even when there were other, more profitable crops, and paid inflated prices as partial compensation. As a result, low-quality grain that nobody wanted to buy piled up in the silos. This further discouraged investment in the land.

Although farm incomes were going nowhere, farmers faced a difficult choice. If they moved off the land, they lost all right to it. They would have to move to the town with no start-up capital, to take whatever low-paid job they could find. But if they stayed on the land, they couldn't attempt anything more ambitious. They were stuck with their half-hectare plot.

Recently, however, things have begun to change. In March, China enacted a Rural Land Contracting Law that, theoretically at least, removes the threat of land reallocation. It also gives lease-holders the power to sub-let the land or even transfer the remainder of the lease to another person. It's easy to see that this reform, if truly implemented, is a major new transfer of property rights from the government to the rural residents.

Not only will there be an incentive to invest in the land and transfer its use to new crops that take longer to grow. In future, the land might be mortgaged to obtain loans needed to finance that investment. The land might be sold to provide the capital to allow the owner to move off the land and start a new enterprise. Those committed to farming could amass larger plots of land to achieve economies of scale.

The Rural Development Institute's Brian Schwarzwald, who was in Hong Kong last week to talk about the reform he and his colleagues have been working on for the last 16 years, says that China has finally understood the central insight of Peruvian economist Hernando de Soto, that property rights free up dead capital. China's 135 million hectares of farmland are worth as much as \$600 billion, and farmers with enforceable 30-year leases could receive somewhere between 75% and 95% of the value.

The only problem is that rural officials are sure to fight back, because they make their living by exercising power over the land. For instance, as long as farmers' ownership of the land is still tenuous, local leaders can take plots away and sell them at much higher market prices to developers. Typically a farmer gets paid between 5% and 10% of the real value of the land in such cases.

The government has been trying to solve the problem of how to support the system of rural cadres without much success. In trial projects in provinces like Anhui and Inner Mongolia, Beijing has eliminated the many taxes levied on farmers and replaced them with a single flat tax of 7% of income. The problem is that this doesn't cover the expenses of the local governments. The central government has to subsidize these programs, meaning that plans to widen the reform throughout the country have fallen by the wayside.

The only way out of this trap is to grow farmers' incomes, and land reform can make it possible. When Taiwan undertook a similar reform in the 1950s, Mr. Schwarzwald says, rice production shot up by 60% and rural incomes increased by 150%. In China we could see a repeat of the

1980s, when inequality between the cities and towns fell, and while many millions of people are still going to have to move off the land in the coming years, this year's land reform could make the transition much more stable.

Moreover, in the last few year China seems to have gotten over its fixation on grain overproduction. With entry into the World Trade Organization, it will no longer pay subsidies to farmers for their crops. There will still be some direct payments, but these will no longer distort farmers' decisions on what to grow.

If Beijing wants to get itself out of the rural poverty trap which former Premier Zhu Rongji proclaimed as his "biggest headache," it will have to get tough with the local officials. As Mr. Schwarzwald says, in this case the interests of the higher officials and the farmers are aligned. As well as seeing another lesson in the power of property rights, Beijing is learning how important the rule of law can be to development. The coming months will tell whether the Party is willing to create the institutions needed to force its own cadres to respect the land contracts. That would be a valuable new precedent on a par with Deng Xiaoping's Household Responsibility System.

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