



Green Box Support Measures Under the WTO Agreement on Agriculture and Chinese Agricultural Sustainable Development

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Executive Summary

Introduction

China's entry into the WTO will not only bring about more development opportunities with the opening of domestic and international markets and resources, but will also expose the country to greater global competition. More significantly, it will accelerate the formulation of laws, regulations and a policy framework that accord with the principles and rules of market economy and internationally accepted business practices. Agriculture formed a key area in China's accession talks, and the issues of domestic support policy, followed closely at home and abroad, featured prominently during China's agricultural negotiations. The impact of China's WTO accession essentially lies in China's domestic agricultural policies that must be bound by multilateral trade agreements and that it must fulfill all its commitments made during the accession talks. In other words, the impact is not just confined to the trade of agricultural products and the contribution of this trade to foreign exchange revenue, but to a greater extent it will result in the readjustments of the country's agricultural development policies. These readjustments will further commercialize Chinese agriculture, optimize the agricultural structure and raise the efficiency of the sector. In view of the peculiar national conditions, however, these readjustments, when inappropriately made, may also produce some negative effects, leading to the contraction and recession of its agriculture or even shaking the status of the sector as the foundation for China's national economic development.

The paper studies the issues of whether/how the Green Box policies/measures best suit the needs of structural adjustments in the post-WTO era, enabling China to effectively cope with the challenges arising from the transformation of economic systems/structures and the market opening, as faced by its agricultural sector. These issues are also coupled with the goals of achieving sustainable development in the sector. Furthermore, the paper attempts to provide some thoughts and recommendations for further reform of the multilateral rules on the Green Box from the perspective of China.

WTO disciplines on agro-domestic support and policy trends in major WTO members

One of the landmark achievements in the Uruguay Round Agreements Act (URAA) has been the extension of multi-disciplines from border measures in agriculture into domestic policies. Compared with other sectors, agriculture in the world's economies, especially the developed ones, has long enjoyed a rather brawny domestic support. Moreover, substantial domestic support epitomizes the original source of trade distortion, which will not disappear if border measures continue to be the sole means of balancing. For this reason, more consolidated reform is necessary if the national protection of their agricultural sector is to be reduced.

URAA rules on direct domestic support policies that are most trade-distorting and directs them toward lesser or minimum distortions. Under the broad WTO umbrella, domestic support policy instruments are usually classified into three categories. Support policies that are the least or minimally trade distorting are placed in the "Green Box," which can be exempted from reduction commitments. Also exempted are certain domestic investments and input subsidies in developing countries that qualify as "special and differential." Support instruments deemed to be the most trade distorting are classified as "Amber Box" policies, which are subject to a reduction in installments. Direct payments under

production-limiting programs are contained in the “Blue Box,” with distorting effects between those instruments in the Green and Amber Boxes.

Under the framework of the URAA that was implemented since 1995, the general trend of WTO members’ domestic support has been the increased use of Green Box measures and decreased use of Amber Box measures that have the most distorting effects on production and trade. As many countries decreased Amber Box spending over this period, Green Box became the principal mode for domestic agricultural support. For most developing members, the Green Box was particularly relied upon, and in some cases the only means, to carry out their domestic support. However, with the exception of a few developed members, Green Box expenditure accounted for a very small proportion of their domestic support. Reform was therefore needed to transform more agricultural supports into Green Box measures.

Sustainability of China agricultural development and WTO accession

Agriculture in China has undergone dramatic changes over the past 30 years. China’s traditional agricultural activities are marked by both intensive and meticulous farming on limited soil and the use of relatively rich resources (labour) to substitute for scarce resources (water and land). But as the population grew, this farming mode could hardly meet the needs for grains and raw materials for industrial use. In the late 1960s, Chinese agriculture entered into a development stage characterized by heavy input, which not only involved increased use of chemical fertilizer and pesticides, but continued efforts to turn marginal lands into farm land.

Although China has achieved great success in feeding its people with limited resources (feeding 25 per cent of world’s population with seven per cent of the world’s arable land), it is still confronted by two fundamental problems: one is the shortage and degradation of resources resulting from inappropriate use and pressure of feeding a large population coupled with a long standing policy of self-reliance for food; the other is a decrease in income growth of farmers along with increasing cost of production, which has not only reflected the generally low returns of agriculture in the market economy but also highlight the difficult situation of surplus labour.

In 1998, The Ministry of Agriculture adopted the “Action Plan for China’s Agriculture in the 21st Century” or “The Agenda 21.” With regards to sustainable development, the Plan aims to maintain steady production growth, safeguard food security, develop the rural economy, raise the income of local farmers, put an end to poverty and backwardness of rural regions, protect the ecological environment, and utilize natural resources in an effective and sustainable way. However, now only steady production growth and food security can be realized, and rest of the goals cannot be readily fulfilled in the short run, especially for ecological environmental protection and raising farmers’ income.

China accession to WTO adds new complexities and uncertainties to the sustainability of agricultural in China but also provides new opportunities to address the issue.

Agricultural restructuring after accession to WTO and its impacts on sustainable development of agriculture in China

After 15 years of tough negotiations, China finally made its entry into the World Trade Organization by the end of 2001. The accession implied that China would carry out an overhaul of its agricultural policies, in the light of the URAA rules and regulations. At the time of China's accession, the WTO members were debating and framing up the trading norms for agricultural products, the first ever attempt by the organization. The URAA, concluded at the Uruguay Round, is the result of this endeavour. For the first time ever, the URAA stipulated multilateral disciplines on market access, domestic support and export subsidies, blazing the trail for the liberalization of world trade on agricultural products. But the agreement was constructed in such a way that it best suited the actual conditions of the developed countries, with little consideration to the particular needs of agricultural development of the developing countries. Based on a package of agreements, China signed its protocol for WTO accession, which listed, among other things, the commitments in the agricultural sector. These included: removing state-set prices for major agricultural products, reducing tariffs, lifting export subsidies, establishing import tariff quotas to provide minimal market access, permitting non state-owned trading firms to deal in grains trade, and confining domestic agricultural support to 8.5 per cent. These commitments represent substantial reform of not only China's agricultural policies, but are also changes that even major members of the WTO have not yet undertaken. Provided that the above-mentioned commitments are fulfilled, China's agricultural trade barriers will be notably lowered compared with those of the United States and the EU.

While the WTO accession is not critically affecting the aggregated balance of China's agricultural sector in the short-term, it will produce multi-dimensional effects on Chinese agriculture, triggering a series of structural changes in the long run. The changes, among others, will include the following:

- Widening the gap between agriculture and other sectors and shrinking the share of agriculture in the nation's GDP as a result of faster growth rates achieved by the manufacturing and service sectors, fuelled by foreign direct investment;
- Declining overall acreage for grain production and increasing production and export of labour-intensive crops, of which China enjoys some comparative advantages.
- Weakening the regional patterns of agriculture guided and shaped by the self-supply and self-sufficiency philosophy, and strengthening the exchanges of goods best produced by local most-abundant resources. In the wake of a deregulated import market, the southern regions will be less dependent on grains grown in the north and will seek more imports instead. The major grain produced in northern regions on the other hand will seek more export opportunities.
- Integrating the decentralized system of owner-peasant, that is under increasing pressure of international competition, and will cease to function well.
- Significantly changing the rural employment share and composition. As market opening and integration intensifies, the conflict between large population of rural labour forces and limited amounts of arable land becomes more and more acute. There exists a great need to transform those surplus labours to the profitable manufacturing and service sectors.

These structural changes will exert both positive and negative impacts on sustainability of agricultural development in China. The market opening will help turn local agriculture into a more intensified, industrialized, commercialized, organized and more outward-oriented activity, thus greatly improve the efficiency of resource utilization of the sector. However, heavily subsidized cheap imports will further increase farm hands surplus, reduce farmers' income and aggravate rural poverty. In turn, the growth of a poverty-stricken population will, make it more difficult to enforce ecological protection efforts, further deteriorating the ecological environment of the rural regions.

Whether the WTO accession aggravates the difficulties for China to strive for agricultural sustainable development will depend to a certain degree on the development of the regional economies and the demand for Chinese labour-intensive agricultural products by both domestic and world markets. It will, to a greater extent, depend on the readjustment of China's agricultural policies and the new rules and regulations to be formulated at the next round of multilateral trade negotiation on domestic agricultural support, market access and export subsidies.

China's Green Box measures

It is recognized that there is a disparity between what the WTO advocates and China's traditional agricultural trading system characterized by state trading operation and quantitative restrictions. But the country's domestic agricultural support, as categorized by the WTO, falls within the scope of Green Box measures, which are measures with no or very little trade distorting effect and China's Amber Box support remains in the negative. This is mainly because China has not, as a developing member, fully reversed its biases of taxing agriculture and supporting local industry with agricultural surpluses. Unlike some major agricultural countries, China's agriculture is fundamentally domestically-oriented with poor foreign exchange earning records, and its agricultural exports are not as vigorously encouraged as manufactured goods. Although the country's farm products are also subsidized, it is more of a short-term regulating measure adopted in times of bumper harvests and large agricultural reserves, not a long-standing policy.

With the data available for analysis, recent developments have been identified as follows:

- Green Box expenditure accounted for 14.2 per cent of the government's total budgetary expenditures on an average basis from 1996 to 1998 (the most recent data available) and depicted a steady rising share in the latter.
- China's domestic support is basically aimed at food security. Its Green Box support was primarily centered on infrastructure construction and domestic food reserve, both under the government general services category. These two combined accounted for some 60 per cent of the total Green Box measures, which highlights the priority of the country's agricultural support—raising the supply capability and safeguarding domestic food security.
- A number of measures directly linked with producers' income are not adopted on account of the local financial and administrative restraints. Over a long period of time, the priorities of China's agricultural support were to lift production capacities and guarantee steady supplies, and the issue of ensuring and increasing farmers' income was taken seriously by the government only in recent years. Under the current system, there are four Green Box measures aimed toward this end, roughly two thirds of the total. They include direct payment to farmers, decoupled income support, government financial participation in income insurance/safety-net program, structural

readjustment aid provided by farmers retirement program, etc. None of these, however, were adopted in China. With 356 million farmers, or 50 per cent of the total labour force and 2/3 of the gross population in rural regions, China is still one of the poorest countries in the world, and could hardly afford to extend direct fiscal support to its farmers.

- China is in transition to a market economy, its system and institutional arrangements that fit in with market economy development have yet to be fully set up, especially in the agricultural sector where the market is not completely opened and the government still intervenes in production, purchase, sales and pricing of farming products. Moreover, China's agriculture maintains a rather low commercialized rate; it stands merely at 40 per cent, whereas the degree of its grain self-sufficiency for the rural population, some 2/3 of the nation's total, is at around 60 per cent. Hence, Green Box measures, such as marketing and promotion, service and government financial participation in income insurance/safety-net programs, were not included in the country's domestic support programs.
- State support in environmental protection and resources conservation were intensified year after year. Owing to the deteriorating environment, the Chinese government increased spending on environmental protection and spent RMB18.4 billion in 1998, 26 times more than that of 1981. In terms of the outlay channels, China's ecological protection measures were divided into five main parts: water and soil conservation; grassland improvement and protection; forestation subsidy and protection; water resource detection and protection; and resources survey. In recent years, the state fiscal appropriations for ecological protection mainly went to forestry development. To harness worsening soil erosion and depletion, and desertification, the government launched six key forestation projects. Of these, the project of returning grain plots to forestry was targeted, and it involved a large spectrum of areas. The program garnered record participation by the general public, and was implemented under the most stringent policy guidance. The project is far more complicated than any ordinary forestation effort, because it not only involved checking the deteriorated environment, but was also related to issues like the geographic readjustment of future agricultural development, the regulation of property right policy and land ownership in different regions and the migration of farmers in ecologically fragile areas.

China has continually intensified its Green Box support, especially over recent years. The Green Box expenditure represented 9.2 per cent of agriculture production value on an average basis from 1996 to 1998, and has increased year by year, but some major problems persist, which have weakened the effects of these measures.

- The constraints of the regime has led to weakened policy enforcement and reduced effects of the Green Box measures. Under the existing administrative and operational system, payments in the name of agricultural support may not be used for the purpose, and the amount of money used for such support may even be vastly short of the actual amount provided. Because most of the local research institutions are inflated and overstaffed, an overwhelming amount of the research fund has been used as remuneration and benefits packages for staff or other purposes, with very limited sums left for research.

- Subsidies are used to extend the production and distribution sectors, covering a wider range of areas and involving various types of subsidy programs. Many of the programs are not well designed and targeted with a tendency to pursue short term effects.
- There is undue emphasis on subsidizing the distribution rather than the production process, and agricultural subsidies had been unduly concentrated in the distribution process. As a result, producers cannot immediately perceive the incentive and support from the government, and the effects of subsidies aimed at stimulating production and raising efficiency have been reduced to the minimum. Because of the intermediary links between production and distribution, a significant amount of the funds used as agricultural subsidies have been wasted.
- In the implementation of Green Box measures, other supposedly relevant agricultural support policies are not accommodating therefore weakening or even partially offsetting the effects of these measures. In spite of the fact that agriculture contributes some 16 per cent to the nation's GDP and that Green Box support accounts for a huge 14.2 per cent of the state budgetary expenditures (the 1986–89 average), governments at various levels levy a considerable amount of agricultural taxes and fees each year (RMB40 billion from agricultural tax alone), turning China's overall agricultural support into a negative value.
- The structure of the Green Box support is imperfect, in that neither a marketing and promotion service network for agricultural products nor the system of agricultural structural adjustment has been set up. Both are of great importance to sustainable agricultural development, structural readjustments and stable income for farmers.

Greater role of Green Box measures expected

China's comprehensive agricultural support is now negative in value, far below the 8.5 per cent level permitted. Theoretically, this means that many more Amber Box measures can be adopted to meet local development needs. But the country's agricultural support will be centered on Green Box measures owing to the following reasons:

1. The financial resources of the Chinese government are limited, so great attention should be paid to more effective use of the support funds. In the foreseeable future, China is unlikely to dramatically increase public investment in the agricultural sector, so it is therefore all the more necessary to make the best use of the limited capital in an appropriate way. The most direct and effective approach will be to gradually reduce or even abolish agricultural taxes and various fees, and reinforce such Green Box measures as Government General Services, Payments through Structural Adjustment and under Environment Program, Domestic Food Aid and Poverty Relief Assistance.
2. The economic globalization has prefigured the direction for the nation's reform of its agricultural support policies. China's comprehensive agricultural support is now negative in value, far below the 8.5 per cent level permitted. Theoretically, this means that many more Amber Box measures can be adopted to meet local development needs.
3. The implementation of the Green Box policies conforms to the goal of Chinese agricultural market reform and contributes more to the long-term, steady and sustainable development of

China's agricultural sector. Under the current circumstances, Amber Box measures will produce distorting effects on the trade, production and distribution of agricultural products in the long run. This is not only at odds with the conception of the relevant WTO rules, but also constitutes barriers to the reforms of the country's agricultural management system and farming operation mechanism and fetters the sector's long-term development. Hence, preferences must be given to Green Box measures, such as readjusting the national resources allocation pattern by switching the price subsidies previously placed in agricultural product distribution network to measures under the Government General Services. In this more scientific and rational way, the rate of public resources utilization will be tremendously enhanced.

4. In view of the peculiarity of structural adjustment of agriculture in China, which highlights the change of the rural and urban relationship, new policy instruments under the Green Box should be available such as de-coupled payment, income insurance/safety net to help the worst-hit farmers survive from the intensified competitions and radical structural changes perceived so as to prevent the farmer's income from declining.

Need to reform the Green Box

Green Box measures have no doubt promoted the agricultural reform process. These measures have been of great assistance not only to subsidy countries in shifting from price support to mechanisms that are characterized by transparency and are less trade-distorting, but also to developed and developing members in fulfilling a series of social objectives. However, the current regime needs to be strengthened and improved for the following reasons:

Potential distorting effects of Green Box measures on trade

The current Green Box qualifications have provided only a logical and legitimate ranking of policies, rather than one based on economic analysis. For this reason, they can hardly make sure that they shall have no or at most minimal distorting effects on production and trade. The Green Box measures tend to be less trade-distorting than those of the Blue Box, which in turn exert a lesser effect than the measures in the Amber Box. But it is still an empirical issue as to what measures, with how much less distortion, can be placed into the Green Box.

Many studies have shown that the support measures that appear least trade-distorting are actually affecting production or trade. The de-coupled income support measures in the Green Box, no matter how meticulously designed and implemented, can affect production through their impact on income, wealth, expectations, risks and other variables. On one hand, farmers shall possess greater investment capacity with their increased wealth and income while policy payments will offset risks embedded in making production decisions, which shall in turn diminish the weight of unfavourable factors in agricultural investment.

Other measures in the Green Box exhibit similar tendencies, such as income insurance, relief to natural disasters, payments for structural adjustment and agricultural environmental programs. For regional assistance programs, the Green Box also specifies that; "where related to production factors, payments shall be made at a progressively decreasing rate above a threshold level of the factor concerned," which may have potentially distorting effects on production.

Some of the Green Box measures employed by certain members are based on highly distorting policies established in the past. Some other Green Box measures are employed parallel to price support, but transparency is missing when the details of their implementation are reported to the WTO, which leads to serious distortion to production and trade in these measures and their supporting regimes.

As can be seen from the above analysis, it is almost impossible for Green Box support measures to stay unrelated to production and trade. However, it is highly possible to strengthen Green Box discipline to ensure the least trade-distorting effects in the reduction exemption policies. For this reason it is of great necessity to design stricter and more operative criteria for Green Box measures while exercising limitation controls on their dimensions.

Green Box support policies and developing countries

Developing countries share a low level in agricultural protection and support. The market distortion caused by agricultural support is almost imputed to the developed economies. Agriculture is the foundation of economic growth and development for most developing countries and least developed countries, including those net-food importing countries. Most developing countries have certain competitive advantages in agriculture, but their proportion in global agricultural trade has usually been below their due shares.

A scrutiny of the implementation of the Agreement on Agriculture reveals little benefits for the developing countries from the reduction by the developed economies in their domestic support. The increased Green Box measures are not neutral for production and trade, resulting in the retention of resources within the agricultural sector. These measures, though having replaced some of the Amber Box measures, are nevertheless continuing to distort production and trade, still keeping the agriculture of developing countries locked in a disadvantaged position of competition.

The Green Box measures currently in force in the Agreement on Agriculture are biased to the developing countries. The developing countries do not enjoy as much manoeuvrability as the developed countries in using domestic support other than what is contained in the Green Box while many of the Green Box measures are far from realistic for most developing countries.

The lowness of development has made it impossible for the developing countries to switch to decoupled support. In most developing countries, physical conditions are still missing for a direct payment regime, e.g., income registration system. The majority of the developing countries, therefore, cannot afford to increase Green Box expenditures as the developed countries have been doing.

Meanwhile, the developing countries differ greatly from their developed brothers in the concerns in agricultural development. The Green Box reflects more the requirements and policy objectives of the developed countries, and makes few manifestations of the realistic problems typical of the developing countries in promoting their agriculture, such as surplus labour in the rural areas. In fact, developing countries are in greater need of Green Box measures, with which to strengthen power and infrastructure build-up, transform the traditional trade patterns, to carry out structural and regime adjustment, to establish an effective market support system, a legal framework, and a management network. Although the Green Box support does not impose any ceilings on these issues, the problem remains that the developing countries cannot afford to, or lack the facilities to, apply most Green Box measures.

Summing up, the reform in the URAA on domestic support has failed to bring along much material interest to the developing countries. To the contrary, the number of net importers of grains and food products among the developing countries has been on the rise. Some WTO members contend that, unless the developed countries reduce in real terms their domestic support including Green Box, developing countries should be allowed to provide protection to their farmers by retaining a comparatively high tariff barrier or by adjusting their current tariff structure. The ongoing agricultural negotiations should allow developing countries more flexibility in market access, tariff, quota and other taxation controls, granting them the freedom to allocate subsidies for specific purposes. This may allow the developing countries to take action, when fiscal revenues are far from adequate, for protecting the sustainable development of their agricultural sector and for pursuing other objectives.

Proposals to improve Green Box support under the WTO

1. Clarify the definition, strengthen Green Box discipline, and design stricter and more operative criteria for Green Box measures.
2. An important objective of new negotiations should be further substantial reductions in Amber Box, Blue Box and export subsidies. In the reduction of Amber Box, the attention should also be given to capping the subsidies on specific commodities.
3. WTO arrangements should provide sufficient flexibility for developing countries in market access, export subsidies and domestic support to achieve legitimate domestic policy objectives. It is important to have these measures recognized in the WTO ongoing negotiations on agriculture.
4. There should be no extension to the peace clause.

Conclusion

Chinese agricultural policies had long been formulated against the backdrop of short supplies of products and materials, and with the basic goal of satisfying the demand for food through self-sufficiency. Efforts related to the build-up of the policy framework, technical innovations and resources distribution were all made after this basic goal, and a whole set of mutually-supporting agricultural policies was drafted, resulting in quantity-oriented industrial and product structures and corresponding resources distribution setup and technical systems. Meanwhile, some other policy targets were basically ignored, such as enhancement of product quality, streamlining distribution and trade network, better use of resources, environmental protection, narrowing regional development gaps, poverty relief and income growth for local farmers. Starting from the late 1990s, the shortage of agricultural products was gradually relieved, the general demand for food was met quantitatively, and the closed economic environment in which China's self-sufficient policy used to operate no longer exists after the country's WTO accession. As the new situation unfolds, the goal of the domestic policies should be shifted from merely seeking quantities in the past to diversified development in the future. And the strategic mission of the sector should also be shifted from simply relying on domestic market and resources to making full use of markets and resources at home and abroad.

To address the challenges to sustainable development of agriculture arising from structural changes generated from market opening under the current international framework, the role of Green Box measure should be strengthened in designing and construction of Chinese agricultural policy. New

legal, institutional and fiscal structures and arrangements should be set up to facilitate the adoption of Green Box measures and maximize the supporting effects.