



The effect of China's agricultural tax abolition on rural families' incomes and production[☆]



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ABSTRACT

This paper uses the rural household panel data collected by Research Center for Rural Economy to evaluate the impacts of China's agricultural tax abolition during 2004–2005 on farmers' income and production behavior. We find that the abolition of agricultural tax did not significantly affect agricultural production. The effects on input use and productivity are also found statistically insignificant. All these are consistent with the lump-sum property of the tax and imply little effect of the tax abolition on relaxing credit constraints to farmers. Finally, we find that the tax abolition did not increase farmers' net income significantly.

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1. Introduction

Despite China's over 9% annual economic growth rate since 1978, the paces of development between its rural and urban areas are rather uneven. The ratio of urban per capita net income to rural per capita net income experienced a declining period in early reform years (dropped from 2.57 in 1978 to 1.82 in 1983), but then rebounded gradually, reaching 3.11 in 2002. In 2002, the per capita net income in a representative urban family is 7702.8 Yuan, while in a rural family only 2475.6 Yuan.¹ How to speed up the development of rural areas of China, therefore, is of great concern to the central government, reflected from the fact that the themes of the No. 1 decree of Central Government were on “Sannong” (i.e. rural areas, agriculture and farmers) in consecutive 10 years from 2004 to 2013. Among various measures a significant one is the gradual abolition of agricultural taxes. During 2000 and 2003, the central government carried out the tax-for-fee reform (TFR), which abolished local fees levied on rural households in favor of a single agricultural tax. In 2004 and 2005, the agricultural tax rate was gradually reduced. On January 1st, 2006, the agricultural tax was abolished nationwide.

As China's agricultural tax had a history of over two thousand and six hundred years, its abolishment embodies great historical significance. Thus, evaluating the effects of such an event is of great importance to economists and policy makers. However, it is unclear to what extent this abolition would have affected incomes and production of rural households for three reasons. Firstly, given the asserted lump-sum property of the tax, whether the tax abolition had any effect on the agricultural production is an interesting question to study. Secondly, before its abolition, agricultural tax was no longer an important source of government

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¹ According to China's Statistical Yearbook.

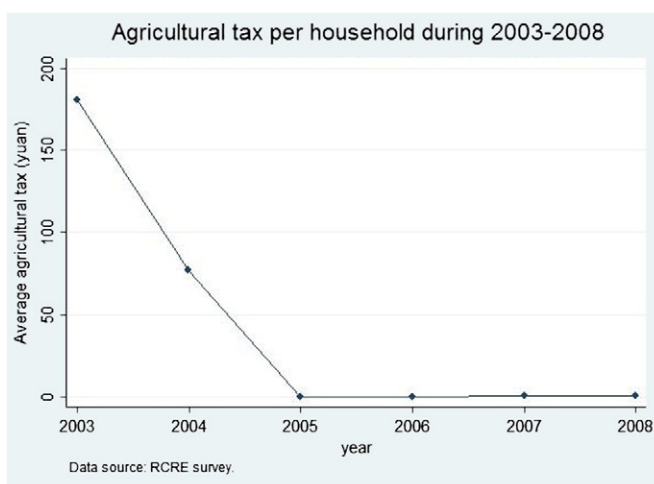


Fig. 1. Agricultural tax per household during 2003–2008.

fiscal revenue. In 1950 the agricultural tax accounted for 39% of government fiscal revenue, but this share dropped to merely 2.6% in 2002. Thirdly, before the abolition the magnitude of the agricultural tax was already negligible. According to the dataset we use in this paper, in 2003, the year before the beginning of tax abolition, the average agricultural tax was only 181 Yuan per household, taking only 2.9% of the agricultural gross income per household (6039.2 Yuan). Moreover, the highest statutory agricultural tax rate was 15%, much less than the traditional tenant share (usually half-half).

While there are quite some studies on the impact of tax-for-fee reform (for example, [Chen, Lei, & Zhou, 2010](#); [Kennedy, 2007](#); [Lin & Liu, 2007](#); [Sato, Li, & Yue, 2005](#); [Tao & Qin, 2007](#); [Xu, Shi, & Wang, 2009](#); [Yep, 2004](#); [Zhou & Chen, 2005](#)),² the existing literature on the impact of agricultural tax rate abolition is thin, possibly due to lack of data. [Gale et al. \(2005\)](#) argue that China's agricultural tax abolition (and implementation of a direct grain subsidy) was symbolically important as a reversal of its historic taxation of farmers, but provided only a modest increase in rural incomes. Based on a general equilibrium model and using simulation method calibrated with data from two villages in Jiangxi Province, [Heerink et al. \(2006\)](#) find that agricultural tax abolition had a positive impact on agricultural production and income, with income effects ranging from 5 to 11%, and that it tended to reduce income inequality within villages. [Yu and Jensen \(2010\)](#) use a computable general equilibrium model to simulate the combined impacts of agricultural tax abolishment and direct grain subsidy provision on China's farming sector, and find a 7.9% increase in agricultural factor income caused by increased returns to land and unskilled labor. Using a partial equilibrium trade model, [Hansen, Tuan, and Somwaru \(2011\)](#) provide an overview of the current agricultural and trade policies in China and study the impact of China's agricultural policy shifts on domestic and international commodity markets. The authors find that domestic production slightly increased as a result of the agricultural reform but its impact on international markets and prices was quite small. In short, the existing literature on the impact of agricultural tax abolition is mainly based on theoretical reasoning or on simulation, but lack of empirical study that uses nationwide household level data.

This paper attempts to fill in this gap by using the panel data collected by Research Center for Rural Economy to evaluate the impact of the abolition of China's agricultural tax on farmers' income as well as on production. Clustering standard errors at the village level, we find that the abolition of agricultural tax had positive but statistically insignificant effect on farmers' agricultural income and production, accounting for potential price changes by also looking specifically at the effects on the outputs of grain. We further examine the impact of the tax abolition on agricultural production through evaluating its impact on overall agricultural production inputs and more detailed input effects on labor, capital and land use. We find no evidence that the tax abolition had significant behavioral effects on rural households.

The remaining parts are organized as follows. [Section 2](#) introduces the characteristics of China's agricultural tax and its abolition, and provides a conceptual framework for the potential impacts of tax abolition. [Section 3](#) introduces the data. [Section 4](#) investigates the effects of tax abolition on household management gross incomes, especially on the agricultural income. [Section 5](#) investigates the channels by which tax abolition might have affected gross incomes; the effects on inputs and productivity are

² [Xu, Shi and Wang \(2009\)](#) use household survey data of 15 villages in Zhejiang, Jiangsu and Shanghai, finding that the tax and fee reform increased household per capita annual income by 6.82% during 1995–2005 and the reform had an insignificant effect on agricultural input while it had a significantly positive effect on capital and land input–output elasticities. In their paper, the tax and fee reform year is defined as the year in which the sum of tax and fees paid by rural families in average decreased significantly (in certain statistical significance level).

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