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Poverty alleviation and rural revitalization in post-2020 China

Challenges and recommendations²

1. This policy note was submitted in October 2020 in response to a request from the Permanent Representation of the People's Republic of China to the United Nations Food and Agriculture Agencies in Rome to provide advice on China's priorities in the areas of poverty reduction and rural transformation after 2020. We hope this note provides some useful insights to inform and contribute to the development of the 14th 5-Year National Development Program (2021-2025).

2. The author of this note is Matteo Marchisio, IFAD Country Director for China. For further enquiries or discussion, please email: m.marchisio@ifad.org.

EXECUTIVE SUMMARY

China has experienced an unparalleled period of economic growth over the past four decades. This period of high economic growth has translated into significant poverty reduction, food security and improvements in various dimensions of human development. China's economic growth and poverty reduction was triggered by a series of reforms that resulted in a surplus of labour in agriculture that migrated to urban areas and was absorbed by the growing manufacturing and service sectors – facilitating China's accelerated industrialization process. Improvements in agriculture played an important role in supporting economic growth and poverty reduction. Today China is a primarily industry- and service-based economy, with an increasingly urban population and a growing middle class. Agriculture is predominately modern and commercial: mechanized, standardized, large-scale and intensive. Extreme poverty is likely to be eradicated by the end of 2020.

However, after about four decades of rapid growth, new challenges are emerging. The factors that led China's growth in the past – resource-intensive industrialization, the reallocation of cheap labour from agriculture to industry, investments in infrastructure, urbanization, demographic dividends – are no longer sufficient to sustain past growth. Agriculture is becoming less and less competitive, while it appears that the past smallholder model is no longer viable or sustainable. Rural areas do not offer sufficient employment opportunities to retain an active labour force, inducing people – particularly youth – to migrate, leaving the elderly, some middle-generation women, children and sick and/or disabled people behind. While China is about to eradicate extreme poverty, addressing relative poverty, reducing vulnerabilities and preventing vulnerable people from falling back into poverty, reducing inequalities and making past poverty reduction achievements financially sustainable, represent emerging challenges that China would need to deal with in the years after 2020. Finally, a range of environmental and climate change challenges unique in scale, complexity and global significance are now emerging as a legacy of the past growth model.

The year 2020 offers an opportunity for China to update its development model to the new context. Past growth has made many achievements possible – not least eradicating extreme poverty – but it has also brought forth several economic, social and environmental imbalances, and cannot be sustained over time. China would need to focus on three priorities in the years after 2020: (1) Sustaining poverty achievements; (2) Reducing geographical disparities and social inequalities; and (3) Ensuring environmental sustainability. Within these priority areas, nine policy actions are proposed: (i) Set a new “vulnerability” line to allow effective targeting in light of the country's new situation; (ii) Reduce anti-poverty subsidies, and increase pro-poor investments instead; (iii) Invest in rural areas to retain the active population; (iv) Focus on off-farm income-generating opportunities, while taking advantage of the opportunities generated by a modernizing agricultural sector; (v) Manage the transition from smallholder agriculture; (vi) Expand the social protection system (*dibao*) and reform the household registration system (*hukou*); (vii) Invest in pollution control and environmental conservation; (viii) Diversify environmental policy instruments; and (ix) “Greening” agriculture: promote sustainable agriculture more widely. The proposed policy actions are in line with and support several of the key priorities highlighted in the Government's Strategic Plan for Rural Revitalization 2018-2022.





CHINA 2020 – PAST ACHIEVEMENTS

China has experienced an unparalleled period of economic growth over the past four decades. China has grown at an average annual gross domestic product (GDP) growth rate of almost 10 per cent, with GDP per capita rising from less than US\$200 in 1980 to about US\$10,100 in 2019. With a gross national income (GNI) per capita of about US\$15,300 in 2018, but a per capita income equivalent to only about a quarter of that of high-income countries, China is considered today an upper-middle-income country.

This period of high economic growth and increase in per capita income has translated into significant poverty reduction, and improvements in food security, nutrition and human development. More than 800 million people have been lifted out of poverty over the past 40 years. It is likely that by the end of 2020, no-one in China will be living on less than US\$1.90/day (adjusted for 2011 purchasing power parity) – the poverty line for extreme poverty. Moreover, the increase in per capita income has been accompanied by broad-based improvements in food insecurity, nutritional status, longevity and other health indicators, and educational attainment of its people.

Land reform and the introduction of the household responsibility system, gradual market liberalization, the opening to international trade and foreign investment, and substantial investments in infrastructure and government transfers triggered the process of structural transformation that underpinned China's economic growth. The rapid transformation and modernization of the agricultural sector that resulted from these reforms generated a surplus of labour in agriculture that migrated to urban areas and was absorbed by the growing manufacturing and service sectors – facilitating China's accelerated industrialization process. Higher wages from more productive jobs and a growing active population generated higher demand for the products of manufacturing in the rest of the economy, and generated higher savings that, in turn, further fed investments and thus the industrialization process. In a few decades, China shifted from being a mainly rural- and agriculture-based economy to an industry- and service-based economy, and from a mainly rural to an increasingly urban society.

Agriculture played an important role in supporting economic growth. Investments in agriculture, which in turn drove productivity enhancement, widespread agricultural commercialization, value chain integration and the associated development of business opportunities across agrifood value chains, have been a significant driver of China's economic transformation. Greater rural-urban connectivity has enabled rural people to benefit from access to urban markets and contributed to the availability of plentiful, affordable food in growing cities. The development of profitable agrienterprises, agro-industry and service providers linked to food production and marketing has spurred the emergence of the industry and service sectors.

In addition to a long period of sustained economic growth, China's success in poverty reduction can be attributed to the combination of a number of factors: an integrated approach to poverty reduction, which combined investments in infrastructure development with investments in the social and economic sectors; precise targeting and tailored poverty reduction measures; and an adequate allocation of resources to pursue this goal.

China today. Today China is a primarily industry- and service-based economy with growing innovation potential, and an increasingly urban society with a growing middle-class. Agriculture today is predominately modern and commercial: mechanized, standardized, large-scale and intensive – employing fewer full-time professional farmers. Agricultural production has been extraordinarily high in recent years, and the country is almost entirely food self-sufficient. Poverty has been drastically reduced, and it is expected that no-one will be living in a condition of extreme poverty by the end of 2020.



THE EMERGING CHALLENGES

After about four decades of rapid growth and development, as China became the second largest economy, is about to eradicate extreme poverty, and will soon reach the status of high-income country, **new challenges are emerging**.

Growth has slowed, productivity is decreasing, returns to investments are diminishing, the surplus of cheap rural labour is declining, the population is ageing and reaching its peak. The past drivers of China's growth – resource-intensive industrialization, reallocation of cheap labour from agriculture to industry, high levels of investments in infrastructure, exports, urbanization, demographic dividends – are no longer sufficient to sustain past growth.

Agriculture is becoming less and less competitive, while government spending on agriculture is growing. The past “smallholder” model does not seem to be viable or sustainable any longer. Costs of domestic production are increasing because of increasing labour and land costs, and domestic prices of the main agricultural produce are in many cases exceeding those on the international market. Profits have fallen, yet government spending on agriculture has grown, particularly on (low-quality products) production – generating agricultural production surpluses that resulted in a drop in prices, to which the Government reacted by increasing market purchase prices to ensure farmers' income. Despite the profound transformation in the agriculture sector over the past 40 years, China's agricultural production and operations still rely extensively on smallholders' participation. It is estimated that there are still more than 200 million smallholder farmers in China. Although the proportion of their income from agriculture is decreasing and it now represents only one third of their income, participation in agriculture remains an important element of rural households' livelihood. The increasing costs of production and the lack of sufficient scale to be competitive, however, make the smallholder model not viable and certainly not sustainable in the long-term – except in those cases of high-value and labour-intensive products. Favouring land consolidation by fostering land rental has been the Government's strategy to achieve a suitable scale for a modern, mechanized and commercial agriculture. However, given the transaction costs associated with aggregating land through land rental and the limited off-farm employment opportunities in rural areas to absorb surplus agricultural labour, it is likely that smallholder production will remain an important feature of China's agricultural sector for some time to come, particularly in mountainous areas.

A large part of the population still live in rural areas. Yet rural areas do not offer sufficient employment opportunities to retain an active labour force, inducing people – particularly youth – to migrate, leaving the elderly, some middle-generation women, children and sick and/or disabled people in rural areas. Although hundreds of millions of people left rural areas and moved to cities to look for job opportunities over the past decades, a large part of the population (about 40 per cent) still live in rural areas. However, rural areas offer limited employment opportunities: agriculture represents a decreasing source of income, farmers spend no more than one third of their time on farming, and the proportion of income from agriculture now represents only one third of rural households' income. While the number of rural people engaged in off-farm activities has increased significantly, it is estimated that only about 40 per cent of the active population manage to find an employment opportunity for longer than six months locally. The rest of the active labour force, half of which is represented by youth between 15 and 34 years of age, most of whom are unskilled, migrate to urban areas. Rural areas today are characterized by a population that mainly comprises elderly people, some middle generation women taking care of elderly parents, young children, and sick and/or people with disabilities.

While China is about to eradicate extreme poverty, the journey towards building a “strong, democratic, civilized, harmonious, and modern socialist society” – China’s long-term goal – is not over yet. According to the World Bank, more than 300 million people are estimated to live on less than US\$5.50 per day (2011 PPP) – the typical poverty line in upper-middle income countries. Some who have been brought out of poverty are still considered to be vulnerable to shocks. Income inequality (between urban and rural areas, between western and coastal provinces and between better-off and worse-off counties in the same province, and between different groups within society – with women, older people, children, disabled people and ethnic minorities being the most vulnerable groups) would still persist after 2020. The financial burden of poverty reduction efforts on public finance has been tremendous. Addressing relative poverty, reducing vulnerabilities and preventing vulnerable people from falling (or falling back) into poverty, reducing inequalities, and making past poverty reduction achievements financially sustainable, represent emerging challenges that China would need to deal with in the years after 2020.

THE IMPACT OF THE COVID-19 PANDEMIC

One of the lessons from the COVID-19 pandemic that hit China in early 2020 is that the poor and the already vulnerable were more severely impacted by the pandemic, making it more difficult for them to move out of poverty (or easier to fall into poverty). Vulnerable people have in fact limited capacity to cope with the impact of unexpected shocks, such as the COVID-19 outbreak: they have limited access to social services – medical care or social protection – and have less capacity to cope economically with the consequences of an outbreak. The lockdown and movement restriction measures implemented to contain the pandemic had an impact on the income of the vulnerable, threatening their food and nutrition security. The impact of the COVID-19 pandemic on the poor and vulnerable was higher because they were already vulnerable: fewer people escaped poverty than would otherwise have done in the absence of the outbreak; and more people fell into poverty because of loss of income. With a gradual pick-up of the economy, the short-term impact of COVID-19 may be contained and absorbed: it may simply take a bit longer to eradicate poverty. However, the longer-term impact may be greater: a large share of the population may have become more vulnerable after the COVID-19 outbreak and be at risk of falling (or falling back) into poverty in the event of a new shock.



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A range of environmental and climate change challenges unique in scale, complexity, and global significance are now emerging as a legacy of the past growth model. Economic and social gains have come with the problem of pollution and natural resource depletion: about one fifth of land resources in China have been polluted, 40 per cent of its land area has been degraded and overuse of water resources has depleted water tables.

Globally, China has become the largest emitter of greenhouse gases. Though much progress has been made in the past two decades, environmental damage continues to harm China's economy through several channels — it affects health, degrades ecosystems and natural resources, and causes losses to agriculture and industry. And while pollution and resource scarcity affect all citizens, poor people are usually most affected and least able to cope.

CHINA POST-2020 – PRIORITIES FOR A POST-2020 AGENDA

The year 2020 marks the transition to a new phase of development for China.

It offers an opportunity for China to further advance its development model: slower but more balanced and sustainable. Past growth has made many achievements possible – not least eradicating extreme poverty – but has also given rise to several economic, social and environmental imbalances, and cannot be sustained over time. High investment rates of the past have resulted in the rapid accumulation of debt, making the economy financially vulnerable. Average income in urban areas is still almost three times higher than that in rural areas. Average GDP per capita in the eastern coastal region is two thirds higher than that of the central, western and north-eastern regions. Although the value of the GINI coefficient (38.6) has been decreasing since 2010, it remains relatively high and is significantly higher than 40 years ago. About one fifth of land resources in China have been polluted, and about 40 per cent of its land area has been degraded. Addressing these imbalances would require a re-thinking of the development model – more focused on productivity, quality, innovation, and environmental sustainability.

China would need to focus on three priorities in the years after 2020:

- 1. Sustaining poverty achievements** (i.e. reducing vulnerabilities, preventing people from falling/falling back into poverty, and reducing the heavy dependency on injections of public resources for poverty reduction);
- 2. Reducing spatial/geographical/digital disparities and social inequalities** (i.e. between urban and rural areas, between western and coastal provinces, between better-off and worse-off areas, and between different groups within society); and
- 3. Ensuring environmental sustainability.**

The role of agriculture. The contribution of agriculture to GDP has steadily declined since the 1980s and is expected to continue to decline, but agriculture still has potential to contribute to overall growth through industrialization of the sector and the expansion of the service industries linked to agriculture: post-harvesting, agroprocessing, food services (e.g. trade, restaurants, catering, prepared food). The expansion of agricultural value chains to agroprocessing and to other service industries linked to agriculture can in addition generate new employment opportunities in rural areas and facilitate the release of agricultural labour to other more productive sectors of the economy, while retaining people in rural areas.



POLICY RECOMMENDATIONS – THREE PRIORITIES, NINE RECOMMENDATIONS

Within the above three broad priority areas, nine policy actions are proposed:

1. Sustaining poverty achievements

- (i) **Redefine targeting: setting a new “vulnerability” line.** Eradicating extreme poverty has been the overarching goal of Chinese society over the past 40 years, and people living in extreme poverty were the main target of China's poverty reduction programmes. By the end of 2020, it is expected that no-one in China would be living on less than US\$1.90 per day, the international poverty line for absolute poverty. However, even if above the poverty line for absolute poverty, a large share of the population will remain clustered above but close to the poverty line. More than 300 million people – or about 24 per cent of the population – are estimated to be living on less than US\$5.50 per day, the poverty line in upper-middle-income countries. These people are not eligible and do not benefit from social protection programmes, the *dibao* programmes, but remain vulnerable to shocks, and at risk of falling (or falling back) into extreme poverty – or remain trapped in a state of relative poverty. Setting a new poverty line (or “vulnerability” line), which reflects the new situation in the country – and possibly moves from a concept of “absolute” to a concept of “relative” poverty, captures the “multidimensional” nature of poverty (including factors such as access to resources, opportunities and resilience to shocks), and reflects the concept of “vulnerability”, is necessary. Setting a new poverty line will allow effective targeting of the most vulnerable segments of the population.

(ii) Reduce anti-poverty subsidies, increase pro-poor investments. The financial cost of poverty reduction efforts on public finance has been tremendous. It is estimated that the Government spent about US\$150 billion on poverty reduction programmes over the past three years, including through extensive cash transfers to beneficiaries and subsidies to dragon head and state-owned enterprises. While this effort was certainly justified by the pursuit of the highest social goal, it made poverty reduction extremely demanding (and dependent) on public resources. Such an effort cannot be sustained over time, particularly in a context of slower growth. Anti-poverty efforts need to continue after 2020. However, the Government will need to redefine the principles determining the use of public resources for poverty reduction, reducing the use of subsidies, and instead using public resources to increase investments in public goods to attract private investments in poor areas and for the benefit of the vulnerable groups.

2. Reducing spatial/geographical disparities and social inequalities

(iii) Invest in rural areas to retain the active population. Over the past decades, China has experienced a massive migration of the active workforce from rural to urban areas due to the gap between urban and rural salaries and the limited income-generating opportunities in rural areas. Today, 40 per cent of the population is registered in rural areas. This percentage is projected to drop to 31 per cent by 2030, putting pressure on the supporting capacity and social stability of cities and towns, causing high social cost in rural society by separating families, and overall furthering the urban-rural divide – unless measures are taken to economically develop the rural areas. China needs to invest in rural areas, including in human capacity, to create attractive employment and investment opportunities, thus retaining or attracting back the active rural population, and rebalancing the existing divide between urban and rural areas. This is in line with the underlying principles of the recently formulated “rural revitalization” strategy (2017).



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- (iv) Focus on off-farm income-generating opportunities, while taking advantage of the opportunities generated by a modernizing agricultural sector.** The percentage of rural household income from on-farm activities has been declining over time, and, in the context of an increasingly modern and mechanized agricultural sector, it is unlikely that this trend will be reversed. There is limited scope for agriculture to absorb labour surplus in rural areas and, in rural areas, the focus should be placed on creating additional and diversified off-farm income-generating opportunities (e.g. services, tourism, logistics, transport, construction, local entrepreneurship, digital economy). The expansion of the service industries linked to agriculture (e.g. post-harvesting, agroprocessing, food services) has however the potential to attract investors and generate new employment opportunities that could retain people in rural areas, and should be leveraged. Moreover, the application of digital technologies and other innovations in agriculture can help increase agricultural productivity, maintaining a role for agriculture in supporting growth.
- (v) Managing the transition from smallholder agriculture.** Despite the profound transformation in the agriculture sector over the past 40 years, China's agricultural production and operations still rely extensively on smallholders' participation. Although the smallholder model is not viable and certainly not sustainable in the long-term, it is likely that a full transition to a large-scale and mechanized agriculture will take some time, and that smallholder production will remain an important feature of China's agricultural sector for some time in the future. At the same time, the rising demand for high-value agricultural products from an expanding urban middle-class, the rapid transformation of the agrifood value chains, and the spread-out of technological innovations (cellphone coverage, electronic platforms for marketing, etc.) open up opportunities for smallholders, as high-value products are more labour-intensive to produce and generate a higher return per hectare. In this context, China should pursue a dual strategy. On the one hand, integrating smallholders in modern agriculture. This would entail improving their capacity to produce at the required quality standards, and improving their capacity to access high-value and remunerative markets, including through improved collective organization capacity. On the other hand, favouring the release of labour currently engaged in smallholder farming to more productive and remunerative activities. This would require, on the one hand, creating new, off-farm income-generating opportunities in rural areas (see above), and, on the other hand, reforming the household registration system (*hukou*) to remove the disincentives to move away from an inefficient smallholder farming system (see below).
- (vi) Expand the social protection system and reform the household registration system.** With the eradication of extreme poverty in 2020, the current *dibao* thresholds no longer correctly reflect China's level of vulnerability, whereas a large share of the population remain vulnerable to shocks and at risk of falling into poverty even if above the poverty line. It is necessary to revise and expand the *dibao* eligibility criteria to properly cover these vulnerable groups, independently of their household registration (i.e. *hukou*) system. This also calls for a parallel reform of the *hukou* system. There are more than 200 million people who every year regularly migrate from rural areas to urban centres for more than six months. Migrant workers now represent about 15 per cent of the urban population. This group of people have limited access to public services and social protection because of their household registration, making them a particularly vulnerable category of people. It is important that the current *hukou* system be extended to include this category of people. Expansion of the *dibao* system and reform of the *hukou* system would in addition push internal consumption, a new driver for growth.



3. Ensuring environmental sustainability

(vii) **Invest in pollution control and environmental conservation.** China already spends US\$130 billion on environmental protection each year. However, according to government estimates, the country would need up to US\$350 billion annually of green financing through 2030. The investment is significant, but the expected rate of return (a reduction of environmental degradation and resource depletion by 6 per cent of the GNI by 2030, according to the World Bank) would justify the investment.

(viii) **Diversify environmental policy instruments.** China's past approaches focused on "end-of-pipe" control mechanisms, that is to say mechanisms to remove already formed contaminants at the end of the process instead of reducing their creation at source. However, such mechanisms could sufficiently support prevention. China has mainly relied on "command-and-control" measures for environmental protection, but market mechanisms (e.g. pricing to better capture environmental costs, environmental taxes, trading systems for carbon and energy use), which have been relatively underutilized, can offer a different, and possibly more efficient, policy tool for environmental protection.

(ix) **"Greening" agriculture: promote sustainable agriculture more widely.** Agriculture is both a contributor to and a victim of environmental degradation and climate change, and poor rural households are the most vulnerable to the effects of environmental degradation and climate change. Despite recent improvements in the rate of utilization of water and land, and although the quality and safety of agricultural products is improving, China's agriculture still faces several challenges due to still excessive exploitation of land resources, overuse of agricultural inputs, and overexploitation of scarce water resources – impacting the quality and safety of agricultural products, in addition to depleting or polluting natural resources. The adoption of sustainable agricultural practices (e.g. technologies that are less polluting and utilize land and water resources more sustainably, crop varieties that are more resilient to the effects of climate change, infrastructure that improves water efficiency) proved effective in reducing the impact of agriculture on natural resources and improving the quality and safety of agricultural products, and should be promoted widely. The application of digital technologies in agriculture can contribute to a more efficient and less polluting use of resources.

The proposed policy actions are in line with and support several of the key priorities highlighted in the Government's Strategic Plan for Rural Revitalization 2018-2022, namely: to promote a better urban-rural integration, to develop and strengthen the rural industry, to accelerate the pace of agricultural modernization, to safeguard and improve rural livelihoods, to build a countryside with a liveable ecological environment and – overall – to build a new pattern of rural revitalization.

Among the proposed policy actions, priority in the next five years should be placed on (i) setting a new poverty line to allow effective targeting in light of the country's new situation, and expanding the social protection system to cover the new vulnerable groups; (ii) increasing investments in rural areas to retain the active population; and (iii) gradually reducing anti-poverty subsidies – increasing pro-poor investments instead.



International Fund for
Agricultural Development
Via Paolo di Dono, 44
00142 Rome, Italy
Tel: +39 06 54591
Fax: +39 06 5043463
Email: ifad@ifad.org
www.ifad.org

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