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China and WTO liberalization: Imports, tariffs and non-tariff barriers

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ABSTRACT

This paper explores the effectiveness of different trade policy instruments on product-level Chinese imports over the period of 2000–2006. More specifically, in addition to the declines in tariffs, we investigate the impact on imports of the gradual removal of non-tariff barriers (NTBs) as agreed within the WTO's accession protocol in 2001 (such as import quotas, licenses and tendering requirements). We document that while manufacturing imports mainly increase because of tariff cuts, agricultural imports grow due to the elimination of import licenses. However, we provide evidence that quota elimination is associated with a redistribution of imports along a larger range of countries, whereas tendering liberalization is connected to an import reallocation from OECD to non-OECD countries. Finally, we also find that NTB protection is complementary to tariff protection and discriminating against foreign-owned manufacturing firms.

1. Introduction

Until the late 1970s, China played a marginal role in world trade, since both imports and exports occurred under a context of a planned economy: for example in 1978, the Ministry of Foreign Trade determined that only twelve state-owned firms could engage in international trade. In the 1980s, China began a process of phasing out the quantitative planning of trade flows and to reform its trade regime, through introducing instead some limits on the trading rights and using more some conventional policy instruments, such as tariffs and quotas. Indeed, import tariff rates initially increased, reaching an average duty rate of around 56% in 1982, and then fell to 43% in 1985, remaining quite stable for the rest of the decade. Quota or license restrictions were still present for almost half of the imports over the same period. However, during the 1990s, China drastically decreased all these trade barriers, so that in 2001 the average tariff rate was around 15%; the share of imports under quota/license regulation fell to 8.5%; and the number of firms with the right to trade abroad increased to 35,000. Moreover, China's import openness was actually even greater once the privileges, introduced for export-processing and foreign-owned firms, were accounted for. As an example, tariff exemptions were introduced in 1987 for the imports of raw materials/parts/components used by the firm for the production of exported goods, as well as for the imports of capital goods by wholly foreign-owned firms (e.g. about 40% of imports in 2000 were duty-free).

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To a large extent the unilateral measures of trade liberalization adopted by China over the 1990s were undertaken as part of the process in its World Trade Organization (WTO) entry, which officially took place on December 11, 2001. Indeed, China agreed to several conditions for its WTO entry that were more stringent compared to other entrants, to not only obtain credibility for its commitments to economic openness through trade with the rest of the world, but also because it believed that those conditions were necessary for the country to benefit from economic globalization.[1] Ianchovichina and Martin (2006) explore how China's WTO accession might influence both China and the rest of the world, by accounting for the export processing regime within the Global Trade Analysis Project model. They first estimate that China would enjoy the largest benefits, due mainly to its own trade liberalization policies. Then, they also find that while the developed economies (especially North America and European Union countries) would gain – thanks to larger export opportunities toward China and a decrease in the costs of imports from China – some developing countries in East Asia are expected to lose — as China will become their most important competitor in third countries.

Through signing the WTO accession protocol, China started to apply the most-favored-nation tariff rates to all WTO members, and among other commitments, to reduce tariffs and on yearly-basis to remove all other non-tariff barriers (NTBs) to imports, such as quotas, licenses and tendering requirements, by the end of 2004. According to the WTO's China Trade Policy Review (2006) – CTPR (2006) henceforth – the average applied tariff rate in China fell to 12.2% after it joined the WTO and still further to 9.7% by 2005. While the phasing out of import quotas, tendering requirements and licenses, as arranged by the protocol, was successful.

This paper aims to explore the evolution of Chinese imports over the period of 2000–2006 and to examine the role played by these different components of trade liberalization, i.e. tariff cuts and the gradual removal of non-tariff barriers (such as quotas, licenses and tendering requirements) as scheduled by China's WTO accession protocol. Moreover, we also attempt to understand whether there is any relationship between tariffs and non-tariff barriers, since one of the main concerns is that the two policy instruments might exhibit a link of perfect substitutability, keeping a constant level of actual protection. More specifically, the current work attempts to address the following research questions: i) is the elimination of non-tariff trade barriers (NTBs) really effective on Chinese imports? Is there any dissimilarity among the different NTB reforms? ii) Is there any relationship between NTBs and tariffs? Do they complement or substitute each other?

While most of the literature analyzing the impact of trade reforms within an economy focuses on import tariffs, several studies have highlighted the relevance of other trade restrictions. In general, they find that non-tariff barriers are on average more trade restrictive than tariffs and in many countries the former contribute relatively more to the overall level of trade restrictiveness than the latter (WTO 2012). For example, using data from 6-digit product lines across 78 countries, Kee, Nicita, and Olarreaga (2009) estimate that the ad-valorem tariff equivalent (AVE)[2] of NTBs[3] was 12% on average (45% if the average is computed only over product lines subject to NTBs) and document that in 55% of product lines subject to NTBs, the AVE of NTB was even higher than the tariff rate. Moreover, their results show that NTBs on average added an additional 87% to the level of trade restrictiveness imposed by tariffs, and in 34 countries NTBs contributed relatively more than tariffs to the overall level of trade protection. Using trade data of 4-digit product lines from the EU and 14 other G-20 countries over the period 2007–2010, Henn and Mcdonald (2011) show that imports decreased by 5%, because of border restrictions applied during the financial crisis, and by 7%, as result of behind-the-border measures. When they further disaggregate the protectionist dummies according to the measure type, they document that both traditional and non-traditional non-tariff measures were more effective than tariffs: such as quota, import ban, competitive devaluation, trade defence measures, licensing requirements and discriminatory purchasing, among import restrictions, as well as bailout and domestic subsidies, among behind-the-border barriers.

The empirical literature on the linkage between tariffs and NTBs is quite scant and provides mixed results. For instance, Ray and Marvel (1984) highlight that the extent of NTBs can either increase as a result of the main multilateral trade negotiations aimed at declining tariffs (substitutability hypothesis), or increase to further reinforce the trade protection from tariffs in textile and agricultural sectors (complementarity hypothesis). More recent evidences have supported either the latter hypothesis (Kee et al. 2009) or the former one (Dean, Signoret, Feinberg, Ludema, & Ferrantino 2009). Limão and Tovar (2011) have developed a theoretical model showing that a government gains from tariff constraint commitments through international agreements – even if this implies the use of less efficient NTBs – when its bargaining power position is weak relative to domestic special interest groups. Using product-level data from Turkey, they find that NTBs increase, following tariff binding or bound tariff reduction, and the latter is more likely to occur when the special interest groups are relatively stronger in their lobbying activities.

Our baseline results show that ordinary import value's growth in China is generally due to both tariff and license liberalization, since the value of imports decreases following tendering liberalization, or is unaffected by quota elimination. In particular, while the license effect concerns the agricultural products, both tariff and tendering effects concern manufacturing products.

A deeper analysis within product highlights that, thanks to both tariff declines and the removal of licenses, China is able to import more from each country, as well as to increase further the range of source countries, especially from the OECD area, i.e. China can access more and better country-varieties. Reverse effects have been found by the elimination of tendering requirements, which would suggest a potential reallocation of imports from high-quality to low-quality varieties. Finally, quota abolition leads to a fall in import intensity per country on the one hand, and an increase in the number of source countries from both OECD

[1] See Branstetter and Lardy (2008), for further details.
[2] AVE is the level of an ad-valorem tariff that would have an equally trade-restricting effect as the NTB.
[3] Their measure of NTBs includes: price control measures, quantity restrictions, monopolistic measures, and technical regulations.